

No. 126446

IN THE SUPREME COURT OF ILLINOIS

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

BRIEF OF *AMICUS CURIAE*
UNITED POLICYHOLDERS

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STATEMENT OF INTEREST OF AMICUS CURIAE

Effectuating the purpose of insurance and interpreting insurance contracts requires special judicial handling. United Policyholders (“UP”) respectfully seeks to assist this Court in fulfilling this important role. UP is a unique non-profit, tax-exempt, charitable organization founded in 1991 that provides valuable information and assistance to the public concerning insurers’ duties and policyholders’ rights. UP monitors legal developments in the insurance marketplace and serves as a voice for policyholders in legislative and regulatory forums. UP helps preserve the integrity of the insurance system by educating consumers and advocating for fairness in policy sales and claim handling. Grants, donations and volunteers support the organization’s work. UP does not accept funding from insurance companies.

UP assists Illinois businesses and residents through three programs: Roadmap to RecoveryTM (disaster recovery and claim help), to Preparedness (preparedness through insurance education), and Advocacy and Action (judicial, regulatory and legislative engagements to uphold the reasonable expectations of policyholders). UP hosts a library of informational publications and videos related to personal and commercial insurance products, coverage and the claims process at www.uphelp.org. A diverse range of individual and commercial policyholders throughout the U.S. regularly communicate their insurance concerns to UP which allows UP to submit amicus curiae briefs to assist state and federal courts decide cases involving important insurance principles. UP has filed amicus curiae briefs in approximately 500 cases throughout the United States since the organization’s founding in 1991.

UP has been actively involved as *amicus curiae* in Illinois courts since 1995 and submitted briefs in recent cases, including: *West Bend Mutual Insurance Co v. New Packing Company, Inc.* (Illinois Appellate Court First District Appeal No. 11-1507); *Maremont Corporation v. Edward William Chesire, et al.* (Illinois Appellate Court First District Appeal No 96-0146); *Employers Insurance of Wausau v. City of Waukegan, et al.* (Illinois Appellate Court Second District Appeal Nos. 2-97-0606 and 2-97-0901); *Country Mutual Insurance Company v. Livorsi Marine, Inc., et al.* (Supreme Court of Illinois No. 99807); *Board of Education of Township High School District No. 211 v. International Insurance Company* (Illinois Appellate court First Judicial District Appeal No. 98-0084); *Benoy Motor Sales, Inc. v. Universal Insurance Company* (Illinois Appellate court, Appeal No. 96-0536); *Avery v. State Farm Mutual Automobile Insurance Company* (Illinois Supreme Court Appeal No. 91494).

In furtherance of its mission, UP cautiously chooses cases and regularly appears as *amicus curiae* in courts nationwide to advance the policyholder's perspective on insurance cases likely to have widespread impact. UP has been advocating for policyholder's rights in the courts for decades. For instance, UP's amicus brief was cited in the U.S. Supreme Court's opinion in *Humana Inc. v. Forsyth*, 525 U.S. 299, 119 S.Ct. 710, 142 L.Ed.2d 753 (1999).

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. R. Stern, E. Greggman &

S. Shapiro, *Supreme Court Practice*, 570-71 (1986) (quoting Ennis, *Effective Amicus Briefs*, 33 *Cath. U.L. Rev.* 603, 608 (1984)).

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>.

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 depreciation.

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 A39-A41 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 26, 2021.

Respectfully submitted,

/s/ Edward Eshoo, Jr.

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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) table of contents and 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 27 pages.

/s/ Edward Eshoo, Jr.

Edward Eshoo, Jr.

CERTIFICATE OF FILING AND PROOF OF SERVICE

I certify that on February 26, 2021, I electronically filed and transmitted the foregoing **BRIEF OF AMICUS CURIAE UNITED POLICYHOLDERS** with the Clerk of the Court, Supreme Court of Illinois 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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Appendix 1



The Insurance Coverage Law Information Center

DEPRECIATION OF LABOR

Should depreciation be applied to demolition, cleaning, and odor control costs following a fire loss?

December 5, 2014

We have a commercial client who suffered a fire damage claim to his retail market. In the course of settlement, the insurance company applied depreciation to the demolition, cleaning, and odor control that is needed on the claim. We do not feel that depreciation is applicable to demolition, cleaning, or odor control methods and should apply only to the replacement or direct repair of the building. We are looking for some guidance on this part of the negotiation.

New Hampshire Subscriber

It has been our position that depreciation should not apply to labor unless a policy explicitly states that it should. We do, however, recognize that courts have come to varying conclusions on the topic. The following excerpt from a column written by a former FC&S editor for one of National Underwriter's publications, *Claims Magazine* discusses some of the court decisions on the topic:

Two similar cases reached the Oklahoma Supreme Court and were answered within a day of each other in 2002. Both cases involved damage to roofs and an ACV settlement, and both addressed depreciation of labor.

In the first, *Redcorn v. State Farm*, the court said that a "roof is the product of both materials and labor," and so depreciation of labor costs were allowable. But in a dissenting opinion, three justices argued that labor costs should not be depreciated. A roof, they stated, was not a single product consisting of "labor-and-shingles," but was a combination of products (shingles and nails) and a service (labor to install). Labor cannot lose value over time.

One dissenting justice also pointed out that prior to the loss the insured had an installed sixteen-year old roof, and to be indemnified meant he was entitled to the value of the sixteen year old shingles plus the cost of installing them.

The second case before the same court (*Branch v. Farmers Ins.*) also dealt with depreciation of labor. In this instance the court was asked to determine if labor costs for tear-off of a damaged roof could be depreciated, or whether these costs properly should be covered as "debris removal"? In answer to the first question, the court said that labor to install the new roof was a cost the insured was reasonably likely to incur, and so it was rightly included within the meaning of "replacement cost." It followed, then, that labor could be depreciated along with materials.

But having said that, the court noted that homeowners policies contained a separate coverage for debris removal following a covered loss. If a roof were damaged to the extent it had to be replaced, then, said the court, the damaged portion was rubble, or debris. And, if the whole roof had to be torn off to repair or replace the damaged portion, then those torn off pieces must also be considered rubble. Therefore, although the cost of the labor to replace the roof could be depreciated, the cost to remove the debris of the old roof could not.

Appendix 2



Shane Smith ▾

My IRMI Online

?

🛒 (0)

Expert Commentary

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What Exactly Is Actual Cash Value? Better Yet, How Do You Calculate It?



Everyone knows what actual cash value (ACV) is, right? Everyone knows that ACV is replacement cost (RC) minus depreciation, right? Well, if everyone knows it, why does it seem that there are so many problems surrounding the issue of ACV at claim time?

 Mike McCracken December 2007 Personal Lines Insurance

Over the years, courts have defined ACV in one of three ways:

1. RC minus depreciation.
2. Fair market value.
3. According to the "broad evidence" rule—a judicious combination of numbers one and two.

Option number one is the traditional insurance industry definition. And, over the years, courts have upheld this meaning and interpretation. A Kansas court summed it up nicely: "The definition of 'replacement cost' stated in the policy as the 'full cost of repair or replacement (without deduction for depreciation)' implies that replacement cost is greater than actual cash value, and that actual cash value must mean 'full cost of repair or replacement (with deduction for depreciation)'. Option number two—"fair market value"—also seems to be a rather straightforward method. It has always been thought of as "what a willing buyer will pay to a willing seller."

Turning to California

In the case of *Cheeks v. California Fair Plan*, 61 Cal. App. 423, 71 Cal. Rptr. 2d 568 (Ct. App. 1998), the California Appellate Court came down squarely on the side of using "fair market value" as the definition of ACV in California. In this case, Mr. Cheeks's home sustained earthquake damage in the Northridge earthquake of 1994. His policy with the California Fair Plan (CalFair) agreed to pay covered losses at "actual cash value at the time of loss, but not more than the amount required to repair or replace the property."

After determining the replacement cost of Mr. Cheeks's loss to be \$563,888, CalFair applied depreciation and the deductible, to arrive at a final ACV payment of \$44,343. Mr. Cheeks contended that the "value" of his home was considerably more than that figure and took the insurer to court. He knew what he could get if he were to sell the house.

Although Mr. Cheeks lost at the trial court level, he appealed. At the appeal level, the court quoted the State Supreme Court in *Jefferson Ins. Co. v. Superior Ct. of Alameda Cty.*, 3 Cal. 3d 398, 90 Cal. Rptr. 608 (1970): "It is clear that the legislature did not intend the term 'actual cash value' in the standard policy form, set forth in section 2071 of the Insurance Code, to mean replacement cost less depreciation."

In deciding in Mr. Cheeks's favor—that ACV means "fair market value"—the appellate court gave this advice to insurers and to those who draft insurance policies: "If it [the insurer] wants to determine 'actual cash value' on the basis of replacement cost less depreciation, all it has to do is say so in the policy."

Turning to Kentucky

I consulted on a commercial property claim in 2005, where calculation of the ACV was the central issue. The risk was a commercial building located in Kentucky. It was insured with a standard commercial property policy for \$590,000 on a replacement cost basis. After a loss, the commercial property policy gives the insured the

option of proceeding with the replacement of the building or of taking an ACV cash settlement. Note that the option is the insured's and that the insurer may not dictate what path he must pursue.

In February of 2004, the Kentucky building was destroyed by a fire. After the fire, the insured obtained two estimates from local contractors who were familiar with the building. Both of these contractors estimated that the cost to replace the building would be around \$750,000. At that point, the insured decided not to rebuild, but to take the actual cash value settlement, as allowed in the policy.

The policy was the standard commercial property policy, with at least one big exception: this policy actually defined ACV as "replacement cost less a deduction that reflects depreciation, age, condition, and obsolescence." By including this definition of ACV in the policy, both parties to the contract—insured and insurer—were limited to this use (and this use only) of the term.

When all calculations were finished, even after applying depreciation to the \$750,000 replacement cost, the ACV was still more than the limit of liability. At this point, the insurer should have just proffered a check for the policy limit and walked away. But the insurer decided to reexamine the situation. It seems that this building was located in a deteriorating neighborhood and that, if he had tried to sell it, the building's owner could only have gotten about \$294,000 for the building—nowhere near the limit of liability of \$590,000. After finding out about the building's rather low market value, the insurer said it would pay no more than the estimated market value of the building, \$294,000.

It was at that point that I became involved. Although I emphasized that I am not a lawyer, my take on the situation, from more than 25 years' experience, was that the definition of ACV in the policy bound both parties to it and that the insurer could not just "willy-nilly" decide to revert to market value for payment when it had already defined how it would pay. In appraisal, a settlement was reached for just under \$590,000. The umpire even chastised the insurer for its efforts to circumvent the wording in its own policy.

An old saying goes: "Be careful of what you wish for—it might just come true." In this case, the advice to the insurer might have been: "Be careful of how you define a term—it may come back to haunt you."

Overhead and Profit

Another sticky point in negotiation between insured and insurer is the application of and payment for "overhead and profit" (O & P). When calculating ACV, some insurers start with replacement cost, then deduct depreciation, then deduct another 20 percent for contractor's overhead and profit.

In *Gilderman and Gilderman v. State Farm*, 649 A.2d 941, 437 Pa. Super. 217 (Pa. Super. Ct. 1994), the Pennsylvania Superior Court clearly said this practice was wrong. This decision was upheld in 1995 by the state supreme court's refusal to review the case. I think the important thing to remember is that the price of anything—a new roof for a home, a car, furniture, or clothing—includes a component for overhead and profit. If I were to go into a car dealer or a clothing store and tell the salesperson that I wanted to buy that car or that suit, but I would be taking 20 percent off the price for "overhead and profit," I'd be laughed out of the store. In the *Gilderman* case, the Pennsylvania Court advised insurers to be careful or they would be laughed out of town as well.

Unless otherwise dictated by statute or court decision, here is how I think overhead and profit should be handled in a homeowners loss:

RC of Damaged Property (no O&P):	\$100,000
Overhead and Profit:	<u>+20,000</u>
Full RC of Damaged Property:	\$120,000
Depreciation, for example, 30%:	<u>-36,000</u>
ACV Payment (RC - Depreciation):	\$84,000

Turning to Florida

In Florida, the issue of overhead and profit and how to pay for a loss had become so bad, so contentious, that the legislature stepped into the fray. Provision 2.d of "Loss Settlement" in the standard HO-3 homeowners policy from Insurance Services Office, Inc. (ISO), says that the insurer will only pay ACV for a homeowners loss "until actual repair or replacement is complete." Paragraph 2.e of the same policy allows the insured to make an initial claim for the ACV of the loss and then take up to 180 days to decide if he or she wants to replace the damaged property.

Again, because of all the problems with homeowner claims and calculation of ACV in Florida, the Florida Legislature took away the ACV option. As of January 2006, paragraph 2.d only applies to mobile homes and paragraph 2.e has been removed.

So what loss settlement options are now open to homeowner insurers in Florida? Forgetting any insurance-to-value problems, insurers are now left with paragraph 2.a of the Loss Settlement provision. There, the policy agrees that it will pay the least of the following amounts

1. The limit of liability.
2. The replacement cost of the damaged portion of the home.
3. The amount actually spent to replace the damaged portion of the home.

And without paragraph 2.d that requires rebuilding prior to payment of the replacement cost amount, insurers must now write a check to the homeowner for the RC of the damaged portion—even if the insured chooses not to rebuild or repair the home. The insurer no longer has any options. It must proffer a check to the homeowner in the amount of the replacement cost of the damaged property, or the limit of liability, whichever is less.

Although there are many complicated issues surrounding homeowners insurance in Florida, I'm convinced that the insurance industry could have avoided the legislature's rather drastic measures in 2006. How? By including a definition of ACV in the homeowners policy.

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Appendix 3

ACTUAL CASH VALUE GUIDELINES

BUILDINGS

PERSONAL PROPERTY

Prepared by
The National Committee on Property Insurance
55 Court Street
Boston, Massachusetts
1982

ANALYSIS OF THE WORDS "ACTUAL CASH VALUE"

III

The drafters of the 1943 New York Standard Policy elected to delete the parenthetical words, ascertained with proper deductions for depreciation, which followed, and were apparently intended to qualify the phrase actual cash value, they reasoned that it was superfluous, redundant, and added nothing which would clarify the phrase.⁶ They believed that cash value meant worth expressed in terms of money and that it was unnecessary to say depreciation must be considered. However, the omission of the words opened up a broad area of controversy within the property insurance field and in the courts. Many were convinced that the meaning of the phrase actual cash value had been altered, changed completely or, in any event, made obscure.

In our attempt to analyze the phrase actual cash value to seek out its meaning and application to property we find that:

<u>Actual</u>	means real, factual, being, existing at the present moment (not fanciful or theoretical nor existing at some time in the past or the distant future.)
<u>Cash</u>	means ready money; currency or coins.
<u>Value</u>	means monetary or material worth. Worth in usefulness or importance to the possessor.

Viewed in light of these definitions, actual cash value of property may be paraphrased as: ITS WORTH IN MONEY AT THE PRESENT MOMENT.

It would appear highly improbable that a reasonable person would, by any process, arrive at the actual cash value of a building without taking into consideration depreciation however it may have been caused . . . whether physical deterioration, functional or economic obsolescence.

CUSTOMARY APPROACHES IN ESTIMATING ACTUAL CASH VALUE OF BUILDINGS

IV

Prefacing any discussion of the approaches to estimating the actual cash value of buildings, it should be pointed out that, considering the millions of buildings covered by insurance, only a relative though extremely important few present any serious problem of valuation for establishing the amount of insurance or the amount of loss in the event of destruction. Reconstruction cost less a reasonable deduction for physical depreciation is the generally acceptable

rule. (Under policies covering Full Replacement Cost, depreciation is not taken.)

While it is true that there can be differences of opinion as to the construction cost of particular buildings and as to the amount of depreciation to be deducted, these are matters of opinion. It is well known that even when builders make competitive estimates using the same set of plans and specifications, the spread from the high bid to the low bid is often as much as 20 to 30 percent. Also, opinions as to the amount of depreciation to be deducted for wear and tear vary considerably . . . depending on whether it is on a flat percentage or taken item by item and based on the probable life expectancy of the item.

The courts vary in their interpretation of actual cash value due largely to the different circumstances and situations under which the question arises. While it is ill-advised to generalize from isolated and specific cases, nevertheless there is a substantial body of opinion and rulings by the courts which apply to most situations encountered.

Disagreements emerge where the actual cash value of buildings, residential and particularly commercial, involve physical, functional and economic depreciation which are such dominant factors that the cost of repairing partial damage or replacing the structure may exceed its actual cash value (i.e., its real worth in cash excluding the land). Many of these controversies have found their way into the courts, resulting in a wide variety of important decisions.

Case law reflects three general tests or categories used by the courts and by appraisers to measure the actual cash value of property:⁷

1. Replacement/Reconstruction Cost, less depreciation, if any
2. Market value, where the property is of such a nature that its market value can be readily determined
3. The Broad Evidence Rule under which any evidence logically tending to the formation of a correct estimate of the value of the property might be considered in determining actual cash value.

**Reconstruction Cost
Less Depreciation -
Total Losses**

As stated earlier, reconstruction cost less reasonable deduction for depreciation, in most instances, has been an acceptable approach for estimating actual cash value. "At one time, this was the only standard for determining ACV. It was felt that all one had to do was calculate the cost of replacing the damaged property (building or contents), subtract a fair amount for depreciation and, with mathematical certainty, one arrived at ACV. This was a quick and easy way to find ACV."⁸

This approach works to most everyone's satisfaction where buildings are of fairly recent construction and where they may show physical depreciation (wear and tear) if any and, little or no economic or functional obsolescence. **Physical depreciation is a visible condition** and, while subject to opinion as to extent, it is generally subject also to negotiation between insured and insurer.

It provides indemnity to the insured on total losses and on most partial losses. The exceptions are to be found in isolated court decisions. (See Partial Losses - Depreciation)

The courts have been fairly consistent and clear on insisting that an old building may not be valued at replacement cost new and that **deductions for physical depreciation** are to be made.

"The actual cash value of the property at the time of loss is not ordinarily the same as the cost of replacing the property with new property with like kind or quality. As to a building, it is the cost of a new building of the same material and dimensions of the one destroyed, **less the amount the destroyed building had deteriorated by use.** Boise Assn. of Creditmen v. U.S. Fire Insurance Co. 44 Idaho 249, 256 P. 523 (1927)."

The right to take depreciation into account in the estimation of a partial loss was, to a great extent, taken for granted before the 1943 Standard Policy eliminated the parenthetical expression "ascertained with proper deductions for depreciation" after the word "value". Since 1943 there has been an increase in the decisions of courts refusing to take depreciation. A widely cited case is Farber v. Perkiomen Mutual Insurance Company, 370 Pa. 480, 88 At. 2d 776 (1952), where the Supreme Court of Pennsylvania so held. The judge observed:

**Reconstruction Cost
Less Depreciation -
Partial Losses**

"As already stated, if the defendants (insurers) wish to bring about a different result under circumstances similar to those present here, they will have to change the terms of their policies in order to achieve this end."

This case involved the so-called rule of consistency; i.e. applying the same percentage of depreciation on the loss side as on the value side where the policy contained a coinsurance clause. The court held the loss was not subject to depreciation, but the value was. The insurers contended that loss and value should be depreciated the same percentage.

In another case involving a coinsurance clause, the court held the parties bound by the appraisal agreement which allowed 20 percent depreciation on the loss side but 45 percent on the value side. The Court, however, plainly stated that in the absence of the appraisal agreement, the Court would allow no depreciation on the loss side. Lazaroff v. Northwestern National Insurance Company, 121 N.Y.S. 2d 122; aff'd 218 App. Div. 672 (1952).

A similar view was taken by the court in Glen Falls Insurance Co. v. Gulf Breeze Cottages Inc. 850, 38 S. 2d 828 (1949) where 50 percent depreciation was allowed in determining value but no depreciation was allowed on the loss.

An important case handed down by a New York court supports no depreciation and contains the following statement by the judge:

"Testimony on behalf of the plaintiffs is that even if allowance were made for new material, the value of the building after repairing it would be no more than it was prior to the fire, and I have reached a conclusion to that effect — moreover, I find that with the use of new materials the plaintiff would have no better building than they had prior to the fire, and in fact, the proof is that the building would lack certain materials and facilities which were a part of the building when the fire occurred." Andrews v. Empire Cooperative Fire Insurance Company, 103 N.Y.S. 2d 177 (1951).

This statement seems to emphasize more than most cases, the reaching out by the court to close the gap between indemnification and betterment.

There are very few cases in which the courts have ruled that depreciation must be taken on partial losses. Of the half dozen or so, most lack a discussion that would justify the deduction, and most involve situations where a deduction for depreciation is so apparent that to rule otherwise would be grossly unjust.⁹

A second approach to estimate "actual cash value" is the "fair market value" approach, a term usually defined as:

Fair Market Value

"The price at which property would change hands between a willing buyer and a willing seller, each having a reasonable knowledge of all pertinent facts and neither being under compulsion to buy or sell."

Appraising is not an exact science and the element of opinion plays a major role. Therefore, the estimating of fair market value can generate wide divergence of opinion among appraisers. In spite of the often quoted definition above, it is seldom that situations for estimating fair market value involve a completely willing buyer and completely willing seller, each having equal negotiating ability.

Appraisers of market value include in their calculation (1) the cost approach, (2) the market data approach and (3) the income or capitalization approach. These various approaches are valued, correlated and weighted to arrive at a final estimate.

- (1) The cost approach takes into account reconstruction cost* less depreciation, i.e. physical deterioration, functional and economic obsolescence.
- (2) The market approach compares the property to sales and listings of similar properties in the same or similar areas.
- (3) The income or capitalization approach measures present worth of expected future net income derived from the property. It estimates vacancy, gross income, expenses and other charges. Net income is capitalized to estimate probable value as an investment.

The "market value" approach is considered the rule in California. See Jefferson Insurance Co. of New York v. Superior Court 475 P. 2d 880 (1970). The California Supreme Court, construing its standard fire insurance policy, held that:

*Note reconstruction cost, not replacement cost. See Replacement Cost v. Reconstruction Cost for explanation of the distinction.

- damage; depreciation.
- (13) Obsolescence.
- (14) Present use of building and its profitability.
- (15) Alternate building uses.
- (16) Present neighborhood characteristics; long-range community plans for the area where building is located; urban renewal prospects; new roadway plans.
- (17) Insured's intention to demolish building.
- (18) Vacancy, abandonment.
- (19) Excessive tax arrears.
- (20) Original cost of construction.
- (21) Inflationary or deflationary trends.

This list, of course, is not intended to include all elements. Each person's claim is as unique as a fingerprint and new elements of ACV always crop up."¹³

Seventeen of these 21 elements or factors relate directly to and have an influence on the market value of a building. Four of them, 1, 12, 20 and 21, relate to and have an influence on the replacement/reproduction cost less depreciation value of a building. If we include or associate economic value with market value, the Broad Evidence Rule offers the only two realistic approaches for estimating the actual cash value of any building whether it be a new one, one of recent construction, one of functional or economic obsolescence, an abandoned building or one about to be demolished. The two approaches are (1) Market/Economic value, (2) Replacement/Reconstruction value less depreciation. Implicit in both of these approaches is the Rule that every fact and circumstance tending to the formation of a correct estimate of the value must be given due consideration.

APPLICATION OF APPROACHES IN ESTIMATING ACTUAL CASH VALUE

V

Insurance underwriters and claim personnel are regularly faced with the problem of estimating the actual cash value of buildings. The underwriter is concerned that buildings are neither over-insured nor under-insured. The claims person's interest is that, in the event of loss, the insured is properly and adequately indemnified within the terms and provisions of the policy. Insureds and producers are likewise concerned.

**Replacement Cost
v. Reconstruction
Cost**

Throughout this study of actual cash value the term replacement/reconstruction cost has been used rather than the word replacement or the word reconstruction, except where the individual words could be used correctly. In both the real estate and the property insurance fields a distinction is necessary between replacement and reconstruction costs. Replacement is held to mean: To provide another functionally equivalent building, though it need not necessarily be an identical building. Reconstruction means: To restore a building to exactly the same design, size and dimensions as it was originally using materials identical as to kind and quality.

**Reconstruction Cost
Less Depreciation**

Whenever reconstruction cost less depreciation meets and satisfies a given set of circumstances, one need go no further in arriving at the actual cash value. As stated earlier, this approach works satisfactorily for the majority of buildings throughout the country. It deals solely with the building as a unit without concern for the value of the land to which it is attached. The actual cash value arrived at will, in most cases, provide indemnity to the insured should the building be damaged or destroyed, if the original estimate was reliable and kept current.

**Replacement Cost
Less Depreciation**

In many rural areas it is very common to find large, older, private dwellings that have become architecturally, sometimes structurally, obsolete. The framing is usually the full "nominal" sizes, i.e. 2"x4" instead of the present-day 1.5"x3.5" and 2"x10" instead of 1.5"x9.25"; many have parquet flooring; non-stock size and type windows and doors; fancy molded casings, baseboards and other trim of oak and chestnut - no longer available; ornamental plaster on wood lath, and ceilings that are nine and ten feet high. The roofing is often heavy slate shingles; there is a box gutter and wide overhanging, ornamental (gingerbread) cornice, and sometimes wood columns in front. It is not unusual to see three or four brick chimneys, with fireplaces in several rooms, most or all closed up after some form of central heat was installed.

When a building like the one described is functioning satisfactorily as a private, single family residence, a practical approach to the actual cash value, and one consistent with the Broad Evidence Rule, is to estimate the replacement cost as defined herein, that is, the cost of a building functionally equivalent though not identical. In most situations this approach will indemnify the insured in the event the building is damaged or destroyed. Any attempt to measure the actual cash value of buildings of this kind on the basis of the reconstruction cost would result in an amount many times the market value and far in excess of the true value to the insured.

There are many occasions when it is practicable to apply a similar approach to the actual cash value of older buildings that are occupied for commercial, manufacturing and residential (multiple family dwellings) purposes but which have been subject to major architectural, structural and plan obsolescence. Replacement with a building that is functionally equivalent and has the same capacity and utility for the occupants or tenants, usually will indemnify the insured physically and economically. Reconstruction cost less physical depreciation would produce excessive insurance requirements — something neither the insured nor insurer desire.

To use market value as the sole and exclusive measure of actual cash value of the buildings that fall into this classification would, in all probability, result in an insufficient amount of insurance to enable the insureds to repair a substantial partial loss and preclude replacing the building in event of a total loss. It would not indemnify the insureds. This is not to deny that, in these cases, there can be and often is a fine line between the application of replacement cost and market value for measuring actual cash value.

Replacement cost and reconstruction cost approaches to actual cash value, as outlined above, are understood easier than the fair market/economic approach. They are also easier to apply because the process closely follows standard and traditional methods for estimating building construction costs. Builders and appraisers, accustomed to the cost per square foot and cubic foot, and the detailed stick-by-stick and brick-by-brick methods of estimating, are very much at home with these two approaches.

**Fair
Market/Economic
Value**

Guidelines For Identifying Buildings in this Classification

While the term market value in itself is readily understood by definition, there is a divergence of opinion as to when and how it is to be used, on what kind of property it is to be used, and to what extent it affects the actual cash value of the property. This raises serious problems for both insured and insurer when trying to establish a proper amount of insurance to be carried. Looking to the Broad Evidence Rule for answers, as it was first enunciated and the numerous elements that have since appeared in court decisions where the Rule has been used, it is quite clear, that buildings that have come within the range of the Rule are those whose actual cash values are closer to fair market value than to replacement/reconstruction cost less depreciation. When the insurance is not adequate to comply with the provisions of a coinsurance clause, and a partial loss occurs, the insured would prefer that the fair market value of the building be the sole measure of its actual cash value, and thus avoid a penalty. When the

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Appendix

4

OHIO DEPARTMENT OF INSURANCE

MARKET CONDUCT EXAMINATION OF

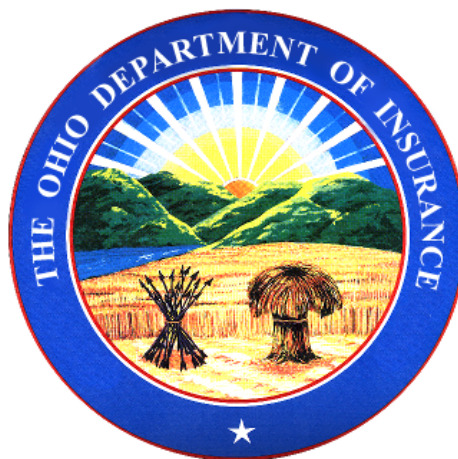
SANDY & BEAVER VALLEY FARMERS MUTUAL

INSURANCE COMPANY

NAIC #10270

As Of

June 30, 2011





John R. Kasich, Governor
Mary Taylor, Lt. Governor/Director

50 West Town Street
 Third Floor – Suite 300
 Columbus, OH 43215-4186
 (614) 644-2658
www.insurance.ohio.gov

Honorable Mary Taylor
 Lt. Governor/Director
 Ohio Department of Insurance
 50 W. Town St. Ste. 300
 Columbus, OH 43215

Lt. Governor/Director:

Pursuant to your instructions and in accordance with the powers vested under Title 39 of the Ohio Revised and Administrative Codes, a target market conduct examination was conducted on the Ohio business of:

Sandy and Beaver Valley Farmers Mutual Insurance Company
 NAIC Company Code 10270

The examination was conducted at the Company's home office located at:
 108 North Market Street Lisbon, OH 44432

and at the offices of the Ohio Department of Insurance located at:
 50 W. Town St. Ste. 300
 Columbus, OH 43215

Respectively submitted,

May 21, 2012

 Lynette A. Baker, CFE, MCM
 Chief, Market Conduct Division

 Date

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COMPANY OPERATIONS

Sandy and Beaver Valley Farmers Mutual Insurance Company is a mutual protective organization organized under Ohio Revised Code (“ORC”) section 3939.01. The Company writes commercial lines farmowners property damage coverage, and personal lines homeowners, church, rental, mobile home, and low value dwelling property damage coverage policies in Ohio. Liability coverage is offered by Grinnell Mutual Reinsurance Company.

The Company markets its business through approximately 200 independent agencies. As of December 31, 2011 the Company has over 14,000 policyholders and reported direct written Ohio premiums of \$6,574,530. It has been in business since 1879.

As of 2011 the Company officers were:

James Sanor	President
Ned Ellis	Vice President
Leroy Sanor	Treasurer

SCOPE OF EXAMINATION

The examination of Sandy and Beaver Valley Farmers Mutual Insurance Company (“Company”) covered the period from July 1, 2010 through June 30, 2011. The examiners conducted file reviews and interviews of company management.

The examination was conducted in accordance with the standards and procedures established by the National Association of Insurance Commissioners (“NAIC”) and Ohio’s applicable statutes and regulations. The examination included the following areas of the Company’s operations:

- Paid Claims
- Denied Claims
- Consumer Complaints
- New Business Underwriting
- Endorsements

This report is a report by tests.

METHODOLOGY

The examination was conducted through reviews of the claims and underwriting files for the Company's property insurance products. The examiners also interviewed Company officers, and made requests for additional information.

Tests designed to measure the Company's level of compliance with Ohio's statutes and regulations, were applied to the files. All tests are described and the results displayed in this report.

All tests are expressed as a "yes/no" question. A "yes" response indicates compliance and a "no" response indicates a failure to comply. The results of each test applied to a sample are reported separately.

The examiners used the NAIC standards of:

7% error ratio on claim tests (93% compliance rate) and

10% error ratio on all other tests (90% compliance rate)

to determine whether or not an apparent pattern or practice of non-compliance existed for any given test. Except as otherwise noted, all tests were conducted on a random sample, taken from a given population of new business or claims records.

In an instance where errors were noted, the examiners described the apparent error and asked the Company for a written response. The Company responded that it concurred with all of the examiner's findings.

The Company's response and the examiner's recommendations, as applicable, are included in this report.

PERSONAL LINES PAID CLAIMS

Timely Initial Contact

Standard: The initial contact by the Company with the claimant is within the required time frame.

Test: Did the Company make timely contact (within 15 days of receipt of loss notice) with claimants following the report of a claim per Ohio Administrative Code ("OAC") 3901-1-54(F)(2)?

Test Methodology:

- The definition of "initial contact" included telephone notice of the claim to the Company or its agent, from the insured, third party claimant, and/or legal representative.
- The examiners considered any initial contact to a first notice of loss where more than fifteen (15) days elapsed to be an exception.

- The examiners considered any instance where initial contact to a first notice of loss was not documented to be an exception.
- The sample consisted of personal lines paid homeowners and fire and extended coverage claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
1031	50	47	3	93%	94%

The standard of compliance is 93%. The Company's handling practices were above this standard.

Examiner Comments:

Two of the exceptions resulted from missing file documentation. The examiners were unable to determine when the Company first contacted the respective claimants. The third exception resulted from the Company taking more than fifteen days (15) to contact the claimant.

Timely Settlement

Standard: Claims are resolved in a timely manner.

Test: Did the Company make timely payments (10 days after acceptance) to first party claimants per OAC 3901-1-54(G)(6)?

Test Methodology:

- The examiners considered claim payments made more than ten (10) calendar days after the amount was known and agreed to be exceptions.
- The sample consisted of personal lines paid homeowners and fire and extended coverage claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
1031	50	49	1	93%	98%

The standard of compliance is 93%. The Company's handling practices were above this standard.

Fair Settlement

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test: Did the Company calculate the settlement amount in a manner that conforms to OAC 3901-1-54(I)?

Test Methodology:

- The examiners considered claim files not containing the actual estimate used to pay the loss to be exceptions.

- In order to be consistent with the industry practice of not depreciating labor, the examiners considered the depreciation of labor to be an exception.
- The sample consisted of personal lines paid homeowners and fire and extended coverage claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
1031	50	50	0	93%	100%

The standard of compliance is 93%. The Company's handling practices were above this standard.

Treasurer Certificate and Demolition Fund

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test 1: If the loss exceeds \$5000, did the company claim settlement practices conform to ORC 3929.86?

Test 2: If the loss exceeds 60% of the aggregate limits, did the Company make an escrow payment as required by ORC 3929.86?

Test Methodology:

- The examiners considered applicable claim files without documentation of Company research into the need for, or evidence of, a county treasurer certificate or payment to a demolition fund to be exceptions.
- The sample consisted of personal lines paid homeowners and fire and extended coverage claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
1031	50	50	0	93%	100%

The standard of compliance is 93%. The Company's handling practices were above this standard.

FARMOWNERS PAID CLAIMS

Timely Initial Contact

Standard: The initial contact by the Company with the claimant is within the required time frame.

Test: Did the Company make timely contact (within 15 days of receipt of loss notice) with claimants following the report of a claim per OAC 3901-1-54(F)(2)?

Test Methodology:

- The definition of “initial contact” included telephone notice of the claim to the Company or its agent, from the insured, third party claimant, and/or legal representative.
- The examiners considered any initial contact to a first notice of loss where more than fifteen (15) days elapsed to be an exception.
- The examiners considered any instance where initial contact to a first notice of loss was not documented to be an exception.
- The sample consisted of commercial lines paid farmowners claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
351	25	21	4	93%	84%

The standard of compliance is 93%. The Company’s handling practices were below this standard.

Examiner Comments:

The four exceptions resulted from missing file documentation. The examiners were unable to determine when the Company first contacted the respective claimants.

Timely Settlement

Standard: Claims are resolved in a timely manner.

Test: Did the Company make timely payments (10 days after acceptance) to first party claimants per OAC 3901-1-54(G)(6)?

Test Methodology:

- The examiners considered claim payments made more than ten (10) calendar days after the amount was known and agreed to be exceptions.
- The sample consisted of commercial lines paid farmowners claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
351	25	22	3	93%	88%

The standard of compliance is 93%. The Company’s handling practices were below this standard.

Examiner Comments:

Two of the exceptions resulted from the Company not issuing payment to the claimants within ten days (10) of the amount being known and agreed to by the claimant. The third exception resulted from missing file documentation. The examiners were unable to determine when the Company first contacted the claimant.

Fair Settlement

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test: Did the Company calculate the settlement amount in a manner that conforms to OAC 3901-1-54(I)?

Test Methodology:

- The examiners considered claim files not containing the actual estimate used to pay the loss to be exceptions.
- In order to be consistent with the industry practice of not depreciating labor, the examiners considered the depreciation of labor to be an exception.
- The sample consisted of commercial lines paid farmowners claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
351	25	23	2	93%	92%

The standard of compliance is 93%. The Company's handling practices were below this standard.

Examiner Comments:

One exception resulted from the depreciation of painting labor. The other exception resulted from the estimate, used to pay the claim, not being in the file.

Treasurer Certificate and Demolition Fund

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test 1: If the loss exceeds \$5000, did the company claim settlement practices conform to ORC 3929.86?

Test 2: If the loss exceeds 60% of the aggregate limits, did the Company make an escrow payment as required by ORC 3929.86?

Test Methodology:

- The examiners considered applicable claim files without documentation of Company research into the need for, or evidence of, a county treasurer certificate or payment to a demolition fund to be exceptions.
- The sample consisted of commercial lines paid farmowners claims.

Findings:

Population	Sample	Yes	No	Standard	Compliance
351	25	24	1	93%	96%

The standard of compliance is 93%. The Company's handling practices were above this standard.

DENIED CLAIMS**Sampling Methodology:**

- The sample included personal and commercial lines denied claims. These claims were not separated by coverage type due to the population size.
- The examiners removed and replaced sample claims that were closed without payment, and not formally denied, until a sample of fifty (50) was identified and reviewed. Forty-four (44) records were removed and replaced for this reason.

Timely Initial Contact

Standard: The initial contact by the Company with the claimant is within the required time frame.

Test: Did the Company make timely contact (within 15 days of receipt of loss notice) with claimants following the report of a claim per OAC 3901-1-54(F)(2)?

Test Methodology:

- "Initial contact" included telephone notice to the Company of a loss from the insured, third party claimant, and/or legal representative.
- The examiners considered failure to contact a claimant within fifteen (15) days from the date of notice of the claim, when the Company had sufficient information to contact that claimant, to be an exception.

Findings:

Population	Sample	Yes	No	Standard	Compliance
587	50	47	3	93%	94%

The standard of compliance is 93%. The Company's handling practices were above this standard.

Examiner Comments:

Two of the exceptions resulted from the Company not making contact with the claimant within fifteen (15) days. The other exception resulted from missing file documentation. The examiners were unable to determine when the Company first contacted the claimant.

Provisions, Conditions, Exclusions, and Disclosures

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test: If the claim was denied on the grounds of a specific policy provision, condition, or exclusion, did the claim file include documentation that the denial notice contained reference to such provision, condition, or exclusion as required by OAC 3901-1-54(G)(2)?

Test Methodology:

- The examiners considered Company failure to include in its denial a specific reference to the provision, condition, or exclusion that was the basis for the claim denial, to be exceptions.

Findings:

Population	Sample	Yes	No	Standard	Compliance
587	50	36	14	93%	72%

The standard of compliance is 93%. The Company's handling practices were below this standard.

Examiner Comments:

Thirteen (13) of the exceptions resulted from the Company denial letters not specifying the policy provisions wherein the respective losses were excluded. The other exception resulted from the denial letter not being found in the file.

Continuing Investigation Notification

Standard: Claims are properly handled in accordance with policy provisions and applicable statutes and rules.

Test: Was the denial determined within twenty-one (21) days of receipt of properly executed proof of loss, and if not, was notice sent to the insured within the 21 day period and was claimant notified of status of investigation and the estimated time required for continuing the investigation at least every forty-five (45) days thereafter as required by OAC 3901-1-54(G)(1)?

Test Methodology:

- The examiners considered claim files without documentation of written or verbal communication of the need for additional time to investigate, from the Company to the claimant, dated or logged within twenty-one (21) days of receipt of the proof of loss, to be exceptions.
- The examiners considered claim files without notice of continuing investigation letters from the Company to the claimant, stating the need for further time to investigate the claim, every forty-five (45) days, to be exceptions.

Findings:

Population	Sample	Yes	No	Standard	Compliance
587	50	44	6	93%	88%

The standard of compliance is 93%. The Company's handling practices were below this standard.

Examiner Comments:

Four of the exceptions resulted from the Company's continuing investigation letters to the respective claimants not being found in the files. Two of the exceptions resulted from there being no indication of an inspection of investigation found in the files.

MULTI-LINE NEW BUSINESS UNDERWRITING**Underwriting Practices**

Standard: The Company's underwriting practices are not unfairly discriminatory.

Test: Are all applicants underwritten by the same underwriting standards and rules as required by ORC 3901.21(M)?

Test Methodology:

- The examiners considered instances of incorrect building locations, construction years, construction types, public protection classes, product offerings, premium credits, and deductibles to be exceptions.
- The sample consisted of personal lines homeowners and fire and extended coverage policies and commercial lines farmowners applications submitted during the examination period.

Findings:

Population	Sample	Yes	No	Standard	Compliance
8061	100	100	0	90%	100%

The standard of compliance is 90%. The Company's handling practices were above this standard.

MULTI-LINE ENDORSEMENTS**Endorsements**

Standard: All endorsements are filed with the Department.

Test: Did the Company file with the Department any endorsements added to the policy subsequent to a claim being filed as required by ORC 3939.01(A)?

Test Methodology:

- The examiners considered exclusionary endorsements added to policies, mid-term and after a loss to be exceptions.
- The sample consisted of personal lines homeowners and fire and extended coverage policies and commercial lines farmowners claims caused by wind and/or hail submitted during the examination period.

Findings:

Population	Sample	Yes	No	Standard	Compliance
747	50	50	0	90%	100%

The standard of compliance is 93%. The Company's handling practices were above this standard.

CONSUMER COMPLAINTS

Complaints

Standard: The Company shall adopt and implement reasonable standards for the proper handling of written communications, primarily expressing grievances, received by the Company from insureds and claimants.

Test: Has the Company adopted and implemented reasonable standards for handling written communications, primarily expressing grievances, including procedures to make a complete investigation of a complaint and respond as required by OAC 3901-1-07(C)(15)?

Test Methodology:

Prior to the on-site portion of the examination, the examiners reviewed Company complaints for the period 1/1/09-6/30/11.

Findings:

The Company does not have formal written procedures for the handling of consumer complaints. The examiners interviewed Company President, Jim Sanor. Mr. Sanor advised that he reviews and responds to complaints personally, either via phone or written correspondence. He indicated that he does not differentiate in his treatment of complaints directly from the consumer versus from the Department of Insurance. These procedures appear sufficient to deal with the volume of complaints a Company of this size might conceivably receive.

EXAMINER RECOMMENDATIONS

- The Company should work to improve the quality, quantity, and consistency of its claim adjuster notes and other documentation so claim processing activity can be reconstructed.
- Dated logs of all adjuster work activities and copies of all documents should be included in every claim file. In some files the examiners were unable to determine when, or if, contact with the claimant had occurred and/or when the claim adjuster began an investigation.
- The Company should ensure that all claim payments are issued/mailed to the claimant within ten (10) calendar days of the settlement amount being known and agreed to by parties.
- The Company should ensure that all files contain the claim acknowledgement, continuing investigation, and closing investigation letters to the insured, when applicable,
- During interviews with the examiners, the Company indicated that its procedure was not to depreciate labor. The Company should ensure that independent adjuster estimates do not include labor depreciation, in order to maintain consistency between claimant settlements and adherence to Company policies and procedures.
- The Company should ensure that denial letters reference the specific, applicable, exclusionary policy language that led to the denial.

EXECUTIVE SUMMARY

PERSONAL LINES PAID CLAIMS		
Areas of Review	Compliance Standard	Compliance Rate
Timely initial contact	93%	94%
Timely settlement	93%	98%
Fair settlement	93%	100%
Treasurer certificate and demolition fund	93%	100%

FARMOWNERS PAID CLAIMS		
Areas of Review	Compliance Standard	Compliance Rate
Timely initial contact	93%	84%
Timely settlement	93%	88%
Fair settlement	93%	92%
Treasurer certificate and demolition fund	93%	96%

DENIED CLAIMS		
Areas of Review	Compliance Standard	Compliance Rate
Timely initial contact	93%	94%
Provisions, conditions, exclusions, and disclosures	93%	72%
Proper denial and continuing investigation notification	93%	88%

NEW BUSINESS UNDERWRITING		
Areas of Review	Compliance Standard	Compliance Rate
Underwriting practices	90%	100%

ENDORSEMENTS		
Areas of Review	Compliance Standard	Compliance Rate
Endorsements	90%	100%

This concludes the report of the Market Conduct Examination of Sandy & Beaver Valley Farmers Mutual Insurance Company. The examiners, Ben Hauck, Rodney Beetch, John Pollock, and Molly Porto would like to acknowledge the assistance and cooperation provided by the management and the employees of the Company.

Ben Hauck

May 21, 2012

Date

Ben Hauck, AINS, MCM
Examiner-in-Charge

Appendix 5

Powerclaim

Found at: <https://docplayer.net/17724934-Welcome-to-powerclaim-net-services.html>

Estimate Settings

File Number: A-0001
Claim Number: Sample

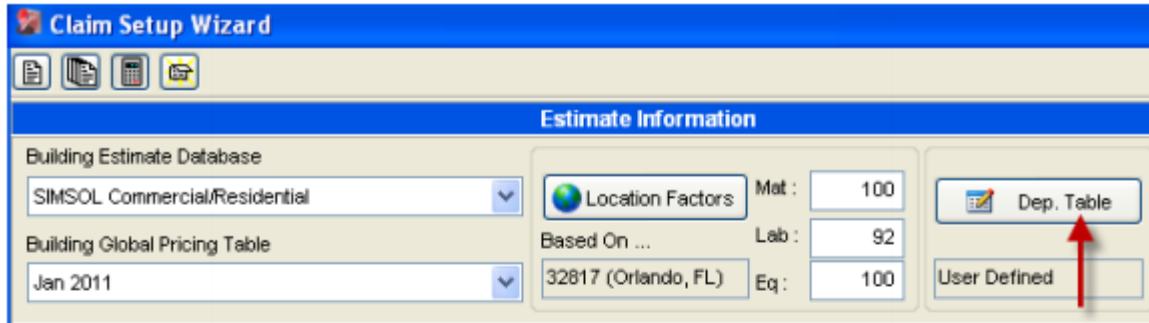
Tax Options	Overhead & Profit Options
<input type="checkbox"/> Include tax in estimates Material Rate: <input type="text" value="0"/> % Labor Rate: <input type="text" value="0"/> % Equip Rate: <input type="text" value="0"/> %	<input checked="" type="checkbox"/> Add O & P to estimate Overhead: <input type="text" value="10"/> % Profit: <input type="text" value="10"/> % <input checked="" type="checkbox"/> Non-cumulative O & P <input checked="" type="checkbox"/> Depreciate O & P <input checked="" type="radio"/> Add O & P to each line item cost <input type="radio"/> Show O & P in coverage totals
Regional Cost Adjustment Base (No adjustment) Material: 100% Labor: 100% Equip: 100% <input type="button" value="Select"/> <input type="button" value="Clear"/>	Depreciation Options <input checked="" type="checkbox"/> Depreciate Tax <input checked="" type="checkbox"/> Depreciate Labor Default Item Depreciation: <input type="text" value="10"/> %

- Tax and Labor can be optionally depreciated. Choose the appropriate settings for the defaults.
- The "Item Depreciation" field will set a default depreciation for all new line items.

Simsol

Found at: <https://windnetwork.com/wp-content/uploads/2014/01/Simsol.pdf>

Methods of Depreciation: Using the Simsol Table w Materials Only Selected



Claim Setup Wizard

Estimate Information

Building Estimate Database: SIMSOL Commercial/Residential

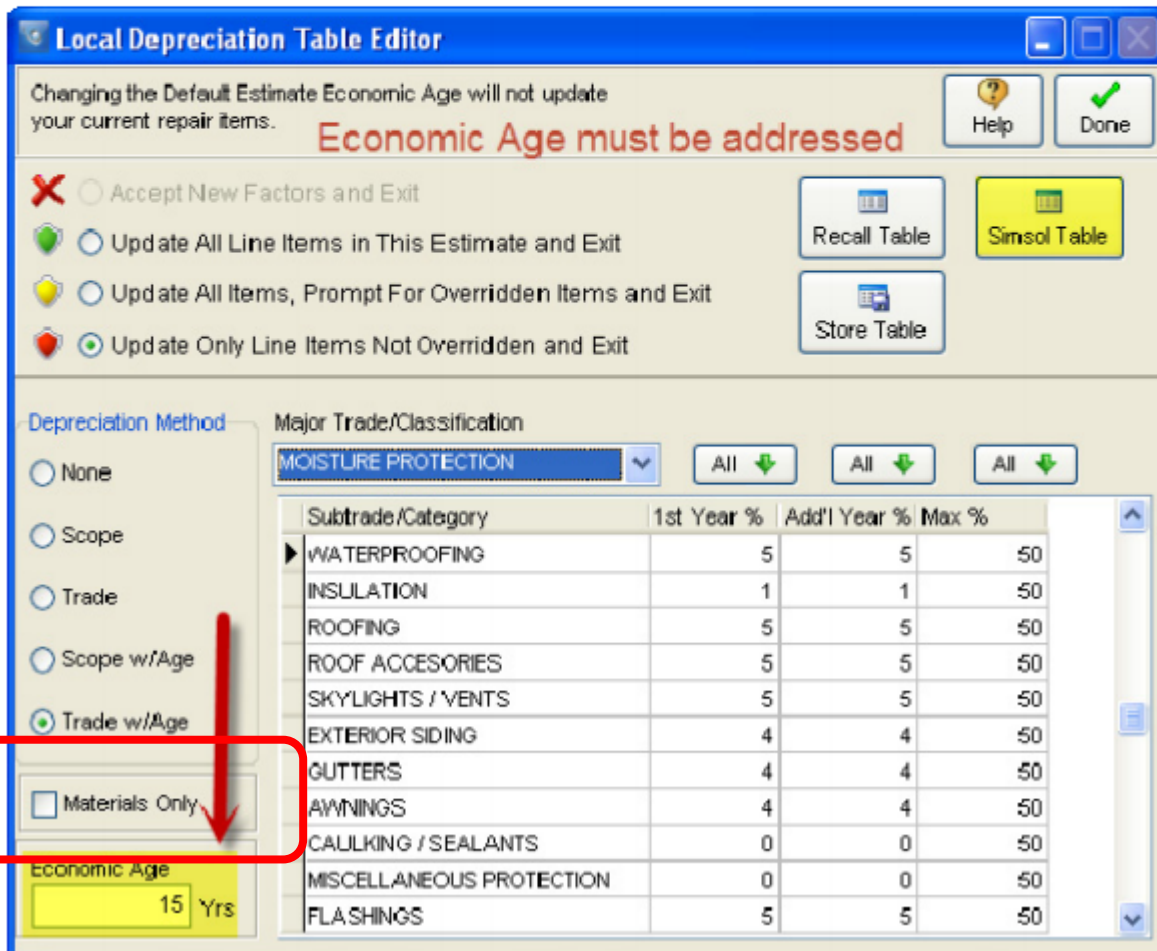
Building Global Pricing Table: Jan 2011

Location Factors: Based On ... 32817 (Orlando, FL)

Mat: 100, Lab: 92, Eq: 100

Buttons: Dep. Table (highlighted with a red arrow), User Defined

The **Local Depreciation Table Editor** screen is displayed by clicking the **Dep. Table** button located on the **Building Estimate Information** or Wizard Screen (see graphic below):



Local Depreciation Table Editor

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

Buttons: Help, Done, Recall Table, Simsol Table, Store Table

Options:

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

Depreciation Method:

- ☐ None
- ☐ Scope
- ☐ Trade
- ☐ Scope w/Age
- ☒ Trade w/Age

☐ Materials Only (highlighted with a red box and arrow)

Economic Age: 15 Yrs

Major Trade/Classification: MOISTURE PROTECTION

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

Symbility

Found at: <https://www.youtube.com/watch?v=GVUdSCxde14>

