

No. 126446

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**APPEAL TO THE SUPREME COURT OF ILLINOIS**


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

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**BRIEF OF *AMICI CURIAE***  
**AMERICAN PROPERTY CASUALTY INSURANCE ASSOCIATION,**  
**NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES**  
**AND ALLSTATE INSURANCE COMPANY**

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**CERTIFIED QUESTION PRESENTED**

By Order entered on November 14, 2018, the trial court certified the following question to the Appellate Court for interlocutory review under Illinois Supreme Court Rule 308:

Where Illinois' insurance regulations provide that the "actual cash value" or "ACV" of an insured, damaged structure is determined as "replacement cost of property at time of loss less depreciation, if any," and the policy does not itself define actual cash value, may the insurer depreciate all components of replacement cost (including labor) in calculating ACV?

In its decision, the Appellate Court, Fifth District reformulated this question "to the sole issue of whether the cost of labor can be depreciated when determining the actual cash value of a loss as defined under 'Coverage A' of the State Farm policy at issue." *Sproull v. State Farm Fire & Cas. Co.*, 2020 IL App (5th) 180577, ¶ 41, 2020 WL 4251702, \*9 (Ill. App. Ct. July 24, 2020).

**INTERESTS OF THE *AMICI CURIAE***

American Property Casualty Insurance Association ("APCIA") and National Association of Mutual Insurance Companies ("NAMIC") (collectively, the "Associations," and together with Allstate Insurance Company, the "Amici") are leading national trade associations representing property and casualty insurers writing business in Illinois, nationwide and globally. The Associations' members range in size from small companies to the largest insurers with global operations. On issues of importance to the property and casualty insurance industry and marketplace, the Associations advocate sound public policies on behalf of their members in legislative and regulatory forums at the state and federal levels and file *amicus curiae* briefs in significant cases before federal and state courts, including this Court. *See, e.g., Folta v. Ferro Engineering*, 2015



IL 118070, 43 N.E.2d 108 (Ill. 2015); *Bridgeview Health Care Ctr., Ltd. v. State Farm Fire & Cas. Co.*, 2014 IL 116389, 10 N.E.2d 902 (Ill. 2014). This allows the Associations to share their broad national perspectives with the judiciary on matters that shape and develop the law. The Associations' interests are in the clear, consistent and reasoned development of law that affects their members and the policyholders they insure.

Allstate Insurance Company ("Allstate"), with its subsidiaries and affiliates, is one of the largest publicly held personal lines insurers in the United States. Allstate insurer entities hold a nearly 12% market share of Illinois homeowners policies (multiple peril). Nat'l Ass'n of Insurance Comm'rs, 2019 Market Share Reports for Property/Casualty Groups and Companies By State and Countrywide 172 (2020), available at [https://store.naic.org/prod\\_serv/MSR-PB-20.pdf](https://store.naic.org/prod_serv/MSR-PB-20.pdf). Founded in 1931 in Illinois, Allstate's home office is located in Northbrook, Illinois. Allstate's corporate parent, The Allstate Corporation, became a publicly-traded company in 1993. According to the most recently available data from last year, Allstate and its affiliates have approximately 145.9 million policies in force, and consist of approximately 85,000 professionals. Allstate conducts extensive business throughout Illinois. Two of Allstate's affiliates have been sued in Illinois in putative class actions challenging the depreciation of labor when estimating actual cash value on homeowners structural damage claims. *See Hester v. Allstate Vehicle and Property Insurance Company*, No. 20L0462 (filed June 12, 2020, Circuit Court Twentieth Judicial Circuit St. Clair County, Illinois); *Thaxton v. Allstate Indemnity Company*, No. 2020L000908 (filed July 2, 2020, Circuit Court Third Judicial Circuit Madison County, Illinois). Both the *Hester* case and *Thaxton*

case are currently stayed pending the outcome of this case. Allstate has a significant interest in the outcome of this action, and Allstate submits this brief to ensure a well-reasoned and thorough ruling.

### ARGUMENT

Amici submit this *amicus curiae* brief to provide the Court with additional background, context and analysis of the question of law presented. Amici will explain the history and purpose of “actual cash value” insurance, how courts have long recognized that “actual cash value” (ACV) means actual economic value, and how the cost approach for determining ACV (i.e., replacement cost less depreciation) provided for by 50 Ill. Adm. Code 919.80(d)(8) is one of the well-established methods for valuing real property not only for insurance purposes, but also for property tax assessments, real estate appraisals and other purposes.

Since the 19th century, insurance policies have provided for payment of the ACV of covered damage to structures. Today, most policies provide coverage on an ACV basis unless and until the insured repairs or replaces the damaged property. Under these policies, after repair or replacement is completed, a supplemental payment is made so that the total amount paid is the full cost of repair or replacement of covered damage (subject to the deductible and any other applicable provisions of the policy). If, however, the insured declines to make the repairs or fails to demonstrate that she spent more than the ACV in making repairs, the policy provides coverage only on an ACV basis.

For decades, courts across the country, including in Illinois, have interpreted “actual cash value” in accordance with its ordinary, common sense meaning, i.e., the actual value in cash or, in other words, the actual (i.e., true and accurate) economic value

of the damaged property. One of the well-established methods used for estimating ACV, which is provided for in Illinois by Department of Insurance regulation, involves estimating the replacement cost value (RCV) of the damage and then subtracting depreciation. This approach to property valuation is used not only for insurance purposes, but also in some cases for property tax assessments, real estate appraisals and other purposes. When this approach is used to estimate ACV, depreciation is properly applied to the full RCV, not merely a portion of that cost.

In recent years, plaintiffs' attorneys across the country have attempted to create a legal fiction, under which the ACV of damaged property would *not* be an accurate valuation of the property under any standard. Under their theory, where an insurance policy provides for payment of ACV, the policyholder is entitled, as a matter of law, to be paid an amount calculated by estimating the RCV of the damage and subtracting only *the portion of the actual depreciation attributable to the cost of materials*. The argument made is that only the cost of the building materials depreciates, not the cost of labor to install them. But this proposed interpretation of ACV makes no economic sense, and is contrary to court decisions and insurance industry practices stretching back many decades.

Plaintiff's proposed approach is not a recognized method of valuing property for *any* purpose. Rather, it is a creative attempt to subvert the decades-old, long-established definition of ACV. For these reasons and others, Plaintiff's proposed approach has been squarely rejected by a strong majority of state supreme courts that have addressed the issue presented here, including the supreme courts of Oklahoma, Nebraska, Minnesota

and North Carolina.<sup>1</sup> As the North Carolina Supreme Court most recently explained, “[t]he policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense. The value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material components.” *Accardi*, 838 S.E.2d at 457.

As *Accardi* recognized, the economic value of the structure, not merely the value of the materials, depreciates over time. The economic value of property cannot be accurately measured by determining its RCV and subtracting therefrom a fraction of the actual depreciation in the property’s value. Plaintiff’s approach would disrupt longstanding insurance industry practice; it would mean that Illinois courts would determine the value of property for insurance purposes far differently from how they value the very same property for tax or appraisal purposes. Such a result would undermine the certainty in the construction of 100-plus-year-old insurance policy language that is essential to not only effective consumer choice but also the stability of the homeowners’ insurance marketplace.

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<sup>1</sup> *Accardi v. Hartford Underwriter Ins. Co.*, 838 S.E.2d 454 (N.C. 2020); *Henn v. American Family Mut. Ins. Co.*, 894 N.W.2d 179 (Neb. 2017); *Wilcox v. State Farm Fire & Cas. Co.*, 874 N.W.2d 780 (Minn. 2016); *Redcorn v. State Farm Fire & Cas. Co.*, 55 P.3d 1017, 1021 (Okla. 2002); *but see Lammert v. Auto-Owners (Mut.) Ins. Co.*, 572 S.W.3d 170 (Tenn. 2019); *Adams v. Cameron Mut. Ins. Co.*, 430 S.W.3d 675 (Ark. 2013) (legislatively overruled by Ark. Code Ann. § 23-88-106).

**I. FAILING TO DEPRECIATE THE FULL VALUE OF DAMAGED PROPERTY WOULD BE CONTRARY TO THE HISTORY AND PURPOSE OF “ACTUAL CASH VALUE” INSURANCE**

**A. Background on the History and Purpose of “Actual Cash Value” Insurance**

Insurers have been writing property insurance policies providing ACV coverage in Illinois since at least 1857, and in the United States since at least the 1840s. *See, e.g., Peoria Marine & Fire Ins. Co. v. Lewis*, 18 Ill. 553, 554 (1857); *Mutual Safety Ins. Co. v. Hone*, 2 N.Y. 235, 243 (1849) (quoting insurance policy providing for “the loss or damage to be estimated according to the true and actual cash value of the said property at the time the same shall happen”).

For many years, there has been no dispute that the ACV is the actual economic value of the damaged property. *See, e.g., McAnarney v. Newark Fire Ins. Co.*, 159 N.E. 902, 903 (N.Y. 1928) (“[w]e interpret ‘actual cash value’ to have no other significance than ‘actual value’ expressed in terms of money”); *Tyler v. Shelter Mut. Ins. Co.*, 184 P.3d 496, 501 (Okla. 2008) (ACV means “the actual value of property expressed in terms of money”).

For several decades, insurers have provided two distinct types of casualty protection for buildings. “One insures to the extent of the ‘actual cash value,’ i.e., the diminution in value; and the other insures to the extent of ‘the full cost of repair or replacement without deduction for depreciation . . . .’” *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 352 (Ind. 1982); *see also In re State Farm Fire & Cas. Co. (“Labrier”)*, 872 F.3d 567, 575 (8th Cir. 2017) (describing post-World War II advent of replacement cost coverage). What is now the predominant form of property insurance coverage provides combined coverage, in the sense that coverage is provided on an ACV basis

unless and until the insured repairs or replaces the damaged property. After repair or replacement is completed, a supplemental payment is made so that the total amount paid is the full cost of repair or replacement of covered damage (subject to the deductible and any other applicable provisions of the policy). *See Nat'l Sec. Fire & Cas. Co. v. DeWitt*, 85 So. 3d 355, 374 (Ala. 2011). This is the type of policy that Plaintiff purchased from State Farm Fire & Casualty Company (“State Farm”) in this case.

As the Appellate Court acknowledged in the decision below, *Sproull*, 2020 IL App (5th) 180577, ¶ 27, ACV coverage is based on the principle of indemnity, that is, “[t]he insured who suffers a covered loss is entitled to receive full, but not more than full, value for the loss suffered, to be made whole but not be put in a better position than before the loss.” *Labrier*, 872 F.3d at 573; *see also Illinois Mut. Fire Ins. Co. v. Andes Ins. Co.*, 67 Ill. 362, 363 (1873) (“A policy of insurance is only a contract of indemnity, and anything which tends to show that an assured can recover beyond his indemnity, is against the very principle of the contract.”) (internal quotations and citation omitted); *Stendera v. State Farm Fire & Cas. Co.*, 2012 IL App (1st) 111462, ¶ 18, 973 N.E.2d 990, 994 (“An insurance contract is a contract of indemnity. . . . The law does not allow for an insurance loss to turn into a profit because doing so would encourage arson or neglect.”). In estimating ACV based on RCV less depreciation, “application of a depreciation factor would serve to indemnify the insured for the value of that which was lost, but no more.” *Henn*, 894 N.W.2d at 185 (internal quotation and citation omitted). “The limitation of property loss coverage to the insured’s actual loss serves the public policy of preventing over-insurance, which can be an ‘inducement to destroy property in order to procure the insurance upon it.’” *Labrier*, 872 F.3d at 573 (quoting *Daggs v. Orient Ins. Co. of*

*Hartford*, 38 S.W. 85, 87 (Mo. 1896), *aff'd*, 172 U.S. 557 (1899); *see also D & S Realty, Inc. v. Markel Ins. Co.*, 816 N.W.2d 1, 12 (Neb. 2012); *Higgins v. Insurance Co. of N. Am.*, 469 P.2d 766, 773 (Or. 1970).

As the U.S. Court of Appeals for the Eighth Circuit has explained, “[b]y adhering to the core principle of indemnity,” ACV coverage “limits the insured’s covered loss to the value of the damaged asset at the time of the loss . . . .” *Labrier*, 872 F.3d at 575. Thus, “the insured, not the insurer, is responsible for the cash difference necessary to replace the old property with new property.” *D&S Realty*, 816 N.W.2d at 11. The Illinois Department of Insurance explains this to consumers, informing them on its website that ACV coverage “often doesn’t pay enough to fully repair or replace the damage.” Ill. Dep’t of Ins., Consumer Resources, Homeowners & Renters, Shopping Tips & Information (available at <https://insurance.illinois.gov/HomeInsurance/consumerHomeowners.html>) (visited Jan. 15, 2021) (emphasis added). If the insured purchases a replacement cost policy, however, as Plaintiff did here, he can receive a supplemental payment to cover the full cost of replacing old property with new property (and thereby receive an economic gain) simply by making the repairs and submitting a supplemental claim to the insurer. It appears there would be no dispute here if Plaintiff had simply repaired his property and made such a supplemental claim. *See Graves v. Am. Family Mut. Ins. Co.*, 686 Fed. Appx. 536, 539 (10th Cir. 2017) (“Had [plaintiff] wanted to recover the full replacement cost under her policy she should have had the repairs completed by the one-year deadline.”).

**B. Courts Have Long Recognized That “Actual Cash Value” Means Actual Economic Value**

Actual cash value is simply the economic value of property. “Actual cash value is the value of the property in its depreciated condition,” in other words, “a representation

of the depreciated value of the property immediately prior to damages,” which is typically used by the insured to provide a deposit to a contractor to start repairs. *Henn*, 894 N.W.2d at 185, 189 (internal quotations and citation omitted); *see also Lampe Mkt. Co. v. Alliance Ins. Co.*, 22 N.W.2d 427, 428-29 (S.D. 1946) (ACV means “‘actual value’ expressed in terms of money”); *Patriotic Order Sons of Am. Hall Ass’n v. Hartford Fire Ins. Co.*, 157 A. 259, 260 (Pa. 1931) (“Actual cash value means what the thing is worth in money, allowing for depreciation.”); *Tyler*, 184 P.3d at 501 (ACV means “the actual value of property expressed in terms of money”); *McAnarney v. Newark Fire Ins. Co.*, 159 N.E. 902, 903 (N.Y. 1928) (“We interpret ‘actual cash value’ to have no other significance than ‘actual value’ expressed in terms of money.”).

**C. The Illinois Department of Insurance Has Recognized That Actual Cash Value Must Be Equivalent to Actual Economic Value**

As the Illinois Department of Insurance explains to consumers, ACV is “[r]eplacement cost less depreciation, considering the age and condition of your property,” and “depreciation” is the “[d]ecrease in *home or property value* due to age or wear and tear.” *See* Illinois Department of Insurance, Consumer Resources, Homeowners & Renters, Definitions (available at <https://insurance.illinois.gov/HomeInsurance/consumerHomeowners.html>) (visited Jan. 15, 2021) (emphasis added). The Department thus explains to consumers that, in estimating ACV, depreciation is based on the value of the home or property, *not* merely the cost of the materials. The Department further explains that “Actual cash value is the value of *your home* considering its age and wear and tear. **Actual Cash Value** coverage pays you for your loss, *but often doesn’t pay enough to fully repair or replace the damage.*” *Id.*, Consumer Resources, Shopping Tips & Information (italics added). The Department also explains to consumers, in the context



of a loss to personal property—and the principles are the same with respect to damage to real property—that ACV is “an amount equal to what the items were actually worth at the time they were damaged or destroyed. For example, it might cost \$1,000 to replace your sofa at today’s prices. If the average useful life of a sofa is 20 years, and your sofa was 10 years old on the day it was destroyed, the company would pay you \$500.” Illinois Department of Insurance, “When Disaster Strikes – What to Do After an Insured Homeowners Loss,” at 5 (available at <https://insurance.illinois.gov/HomeInsurance/disaster.pdf>) (visited Jan. 15, 2021).<sup>2</sup>

The Department of Insurance has adopted the following regulation pertaining to determination of ACV:

A) When the insurance policy provides for the adjustment and settlement of losses on an actual cash value basis on residential fire and extended coverage as defined in Section 143.13 of the Code [215 ILCS 5/143.13], the company shall determine actual cash value, except for instances in which the insured's interest is limited as set forth in subsection (d)(8)(B), as follows: replacement cost of property at time of loss less depreciation, if any. Upon the insured's request, the company shall provide a copy of the claim file worksheet(s) detailing any and all deductions for depreciation, including, but not necessarily limited to, the age, condition, and expected life of the property.

B) In cases in which the insured’s interest is limited because the property has nominal or no economic value, or a value disproportionate to replacement cost less depreciation, the determination of actual cash value as set forth in subsection (d)(8)(A) is not required. In such cases, the company shall provide,

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<sup>2</sup> In *Accardi*, the North Carolina Supreme Court cited a similar consumer guide published by the North Carolina Department of Insurance. See *Accardi*, 838 S.E.2d at 455 (citing N.C. Dep’t of Ins., *A Consumer’s Guide to Homeowner’s Insurance* (2010), [https://files.nc.gov/doi/documents/consumer/publications/consumer-guide-to-homeowners-insurance\\_ch01.pdf](https://files.nc.gov/doi/documents/consumer/publications/consumer-guide-to-homeowners-insurance_ch01.pdf)). The Nebraska Supreme Court also cited a similar brochure from the Nebraska Department of Insurance as supportive of the court’s ruling that depreciation may be applied to the embedded labor component of RCV. *Henn*, 894 N.W.2d at 189.

upon the insured's request, a written explanation of the basis for limiting the amount of recovery along with the amount payable under the policy.

Ill. Admin. Code tit. 50, § 919.80(d)(8) (emphasis added).

This regulation provides for first determining the full RCV, and then applying “any and all deductions for depreciation” that exist as a factual matter. The Department does not impose any restriction on the application of depreciation. The decision below stated that this regulation “specifically pertains to replacement cost of the damaged ‘property,’ less depreciation of that ‘property.’” *Sproull*, 2020 IL App (5th) 180577, ¶ 36. The Appellate Court further stated that “‘actual cash value’ refers to real property—an asset that can lose value over time due to wear and deterioration, resulting from use or the elements[.]” *Id.* The Appellate Court erred in concluding that the “replacement cost” of “property” or “real property” is limited to the value of the building materials. That is plainly incorrect—when real property “lose[s] value over time due to wear and deterioration,” as the Appellate Court described, the loss in value of that “asset” is plainly *not* limited to the value of the building materials. As the North Carolina Supreme Court held, “[t]he value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material components.” *Accardi*, 838 S.E.2d at 457. As another court addressing the same issue presented here further explained, “[t]o adopt plaintiffs’ view that ‘property’—as used in step one of the Policy—equates to ‘all *physical* materials required to produce the covered building but *nothing else*’ strains reason. The ordinary meaning of ‘property’ is ‘any external thing over which the rights of possession, use, and enjoyment are exercised.’ The property owner exercises the right to possess, use, and enjoy the *outcome* of combining labor, tax costs, and materials—*i.e.*,

the property itself in its finished form. In the same sense, defendant indemnified plaintiffs at step one of the Policy against the loss of the value of the *outcome* of combining labor, tax costs, and materials—*i.e.*, the covered property itself.” *Papurello v. State Farm Fire & Cas. Co.*, 144 F. Supp. 3d 746, 770 (W.D. Pa. 2015) (emphasis in original; citations omitted).

Illinois decisions prior to the Appellate Court’s erroneous decision below are in accord with this principle. As the First District explained, “[d]epreciation in an insurance context . . . means the *decrease in the actual value of property* based on its physical condition, age, use, and other factors that affect the remaining usefulness of the property.” *Carey v. Am. Family Brokerage, Inc.*, 391 Ill. App. 3d 273, 281, 909 N.E.2d 255, 262 (App. Ct. 1st Dist. 2009) (citing Black’s Law Dictionary 473 (8th ed. 2004)) (emphasis added); *see also* Section I.D. below.

The decision below also ignored that Plaintiff’s policy insures his dwelling as a whole; it does not provide separate insurance for the materials and for labor. *See Redcorn*, 55 P.3d at 1021 (explaining that policyholder “insured a roof surface, not two components, material and labor”; “[h]e did not pay for a hybrid policy of actual cash value for roofing materials and replacement costs for labor”); *Henn*, 894 N.W.2d at 190 (“The policy does not state that the insured will receive the actual cash value of the materials and the replacement cost value of the labor. As in *Redcorn*, [plaintiff] did not purchase a ‘hybrid policy’ that would allow for this distinction. The policy does not distinguish between materials and labor, and we refuse to read that distinction into the policy.”); *Accardi*, 838 S.E.2d at 457 (“[t]he policy language provides no justification for

differentiating between labor and materials when calculating depreciation, and to do so makes little sense”).

The regulation quoted above, by its own terms, is intended to ensure that ACV is reasonably equivalent to the actual economic value of the property to the policyholder. This intent is demonstrated by subsection (d)(8)(B), which was completely ignored by the Appellate Court, and which provides for the use of alternative methodologies if the methodology in subsection (A), i.e., RCV-less-depreciation, also known as the cost approach, yields a result that is *not* proportionate to the damaged property’s true economic value. The regulation provides that an insurer may use a different method of estimating ACV if “the property has . . . a value disproportionate to replacement cost less depreciation . . . .” *Id.* The regulation thus makes clear that, under Illinois law, the cost approach to ACV valuation (RCV-less-depreciation) is intended to yield the accurate economic value of the damaged property at the time of loss. If Plaintiff’s position were adopted, the methodology set forth in subsection (A) of the regulation would yield an ACV that would almost always be higher than the actual economic value, as explained further below. Such a result would defeat the purpose of the regulation, which, by its own terms, is intended to ensure that ACV is reasonably equivalent to actual economic value.<sup>3</sup>

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<sup>3</sup> The decisions relied on by the Appellate Court fail to address the issue presented here. *Smith v. Allemannia Fire Ins. Co.*, 219 Ill. App. 506 (App. Ct. 5th Dist. 1920) explained that ACV is “the actual value of the property at the time of the loss[.]” *Id.* at 512. *Smith* further explained that, in some (relatively uncommon) circumstances, market value may differ substantially from reasonable “actual value” to the insured (which the court described as the test for ACV). In that case, the facts demonstrated that approximately half of the building was damaged, and the court held that the ACV could not reasonably amount to nearly the building’s entire value because “[s]uch results are absurd.” *Id.* at 511-12. *C.L. Maddox, Inc. v. Royal Ins. Co. of Am.* involved another set of unusual facts, where the parties agreed that the RCV less depreciation was \$345,000, but the fair market value was only approximately \$60,000. 208 Ill. App. 3d 1042, 1054, 567 N.E.2d 749, 757

**D. Courts in Illinois and Elsewhere Have Long Recognized That Depreciation is Properly Applied to the Full Cost of Repair or Replacement**

Courts have long recognized—since the 19th century—that when the cost approach (RCV-less-depreciation) is used to estimate ACV, depreciation is properly applied to the full cost of repair or replacement of damaged property, not merely to one component of value (such as the value of materials but not labor). Back in 1886, in *Commercial Fire Ins. Co. v. Allen*, 1 So. 202 (Ala. 1886), the Alabama Supreme Court explained that “[i]f property had been destroyed which, from use or otherwise, had become less valuable than when new, then *the cost of repairing it, less the percentage of depreciation of the destroyed article* by such use, will determine the extent of the damages.” *Id.* at 208. Early 20th century insurance adjusting manuals confirm that

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(App. Ct. 5th Dist. 1991). There was no dispute or discussion in *C.L. Maddox* regarding how the depreciation was determined. In *Carey*, the court reversed and remanded for a new trial on damages where the policy provided for payment of ACV, but the only testimony was regarding replacement cost, and there was no evidence in the record regarding depreciation. *Carey*, 391 Ill. App. 3d at 282, 309 N.E.2d at 263. In the decision below, the Appellate Court completely ignored decisions, discussed below, in which courts applying Illinois law have recognized that depreciation is properly applied to the *full RCV*, not merely the value of the materials.

To the extent that the decision below appears to focus on circumstances in which the RCV-less-depreciation method reaches a result that differs from market value, that is an uncommon situation. As explained in Section II below, the RCV-less-depreciation method (also known as the cost approach) is one of the methods used by appraisers of real estate to estimate market value. *See Henn*, 894 N.W.2d at 185 (“[d]epreciating the whole is merely one way to arrive at a value that represents the depreciated value of the property to which the insured is entitled”); *Labrier*, 872 F.3d at 574 (“A ‘depreciation’ deduction is the most common, but not the only acceptable *method of estimating the reduced fair market value* of damaged property.”) (emphasis added); *Hicks v. State Farm Fire & Cas. Co.*, 751 Fed. App’x 703, 714 (6th Cir. 2018) (Griffin, J., dissenting) (explaining that majority’s attempt to distinguish states following the “broad evidence rule” for estimating ACV from other states was “a distinction without a difference” because “Kentucky’s replacement cost minus depreciation formula is the *method to calculate the economic value* of damaged property at the time it was damaged”) (emphasis added).

depreciation was applied at that time, as it is today, as a percentage of the RCV, not based on the cost of the materials only. In one handbook from 1924, the author describes a straight-line method of depreciation that applies as a percentage of the full replacement cost: “Suppose half a dozen good contractors agree that it would cost \$100,000 to reproduce a certain building at current rates, but that it was 20 years old, how much would it be worth? Three of them might set a life-time at 40 years, and the other three at 50. In the one case there would be an annual depreciation of 2 ½ per cent to deduct, and in the other 2 [percent].” William Arthur, *APPRAISERS’ AND ADJUSTERS’ HANDBOOK* 36 (1924); *see also* Prentiss B. Reed, *ADJUSTMENT OF FIRE LOSSES* 58-62 (1929). Another handbook from 1982 describes how depreciation is applied to the full RCV of a damaged roof, not merely to the cost of the shingles:

On a partial loss to a structure, depreciation is based on the life span of each item in the building that is damaged. A four-year-old hail-damaged roof with a life expectancy of 20 years, for example, which costs \$5,000 to replace, would be depreciated 20 percent (1/5 of \$5,000 or \$1,000) even though the dwelling may be 65 years old.

Robert J. Prah, *CPCU, INTRODUCTION TO CLAIMS* 88 (Insurance Institute of America 1988).<sup>4</sup>

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<sup>4</sup> *See also Providence Washington Ins. Co. v. Gulinson*, 215 P. 154, 155 (Colo. 1923) (“If \$3016 was the cost of repairs it should have been reduced for depreciation at something like the same rate as the cost of the whole reconstruction, 50 per cent.”); *Boise Ass’n of Credit Men v. United States Fire Ins. Co.*, 256 P. 523, 527 (Idaho 1927) (determining lowest permissible valuation of building based on the evidence of replacement cost and percentage of depreciation per year applied thereto); *Wisconsin Screw Co. v. Fireman’s Fund Ins. Co.*, 297 F.2d 697, 701 (7th Cir. 1962) (Wisconsin law) (affirming district court judgment determining ACV as RCV less 50% depreciation); *Svea Fire & Life Ins. Co. v. State Sav. & Loan Ass’n*, 19 F.2d 134, 136 (8th Cir. 1927) (under Oklahoma law, affirming jury verdict that was consistent with testimony regarding cost of repair less 25% depreciation); *Real Asset Management v. Lloyd’s of London*, 61 F.3d 1223, 1230 (5th Cir. 1995) (recognizing that ACV was properly determined by applying a depreciation percentage to full RCV).

Illinois courts have also recognized for many years that depreciation is properly determined as a percentage of the full RCV, including both the cost of labor and the cost of materials. As an Appellate Court opinion explained long ago:

The total cost of labor and material of all trades, including architect's fees, represented the total reproduction cost. The reproduction cost was the cost of a new building as of the date of the appraisal. To obtain the value of a building, *it was necessary to figure the percentage of depreciation of the building, due to age, wear and tear and obsolescence.* The reproduction cost, depreciated by the ascertained percentages, resulted in a figure which was the *net value of the building*. . . . The rate of depreciation figured by both plaintiff and [a building expert] averaged about 30%.

*Mesce v. City of Chicago*, 301 Ill. App. 429, 440-41, 23 N.E.2d 188, 194 (App. Ct. 1st Dist. 1939) (emphasis added). The Seventh Circuit, applying Illinois law, similarly recognized long ago that depreciation is properly applied to the entire RCV, not merely the cost of the materials. *Knuppel v. American Ins. Co.*, 269 F.2d 163, 166 (7th Cir. 1959) (affirming district court judgment determining ACV based on testimony regarding RCV less depreciation of 2% per year of the building's age, taking into account the building's life expectancy and maintenance). Other Illinois decisions reflect similar methods of applying depreciation to full RCV, not merely the cost of the materials, from 1898 to 1989 and 2013. *See, e.g., Whitten v. Cincinnati Ins. Co.*, 189 Ill. App. 3d 90, 99, 544 N.E.2d 1169, 1174 (App. Ct. 4th Dist. 1989) (depreciation calculated as 12% of RCV); *Niagara Fire Ins. Co. v. D. Heenan & Co., for Use of Nw. Mut. Life Ins. Co.*, 81 Ill. App. 678, 685 (App. Ct. 2d Dist. 1898), *aff'd sub nom. Niagara Fire Ins. Co. v. D. Heenan & Co.*, 181 Ill. 575, 578, 54 N.E. 1052, 1053 (1899) (depreciation calculated at 20% of RCV of certain building components); *Gee v. State Farm Fire & Cas. Co.*, No. 11-CV-250, 2013 WL 8284483, at \*2-3 (N.D. Ill. Sept. 23, 2013) (holding that sales tax was properly included in RCV to which depreciation was applied to estimate ACV).

Plaintiffs' lawyers have incorrectly suggested that the advent of claims estimating software resulted in insurers beginning to apply "depreciation" to labor costs. To the contrary, as demonstrated by the historical handbooks cited above, insurers for decades applied depreciation, in an appropriate percentage, to the full estimated RCV of, e.g., a damaged roof; they did not apply depreciation merely to the cost of the materials. The advent of claims estimating software is what has led to inventive arguments by plaintiffs' attorneys that the value of individuals' labor is being "depreciated," when in fact it is the actual economic value of an aged roof that is being estimated by applying depreciation to the RCV of the roof in essentially the same manner as was done decades ago when property insurance adjusters were doing the calculations by hand or with a calculator, rather than using software.

Some courts (most notably, the majority in *Hicks*) have erroneously suggested that the application of depreciation to the full RCV in estimating ACV is appropriate only in jurisdictions that have adopted the broad evidence rule or a fair market value standard for ACV. The rationale of the appellate decisions supporting State Farm's position was *not* limited to the broad evidence rule or fair market value standards, but rather was also based on the plain language of the policy and common sense. *See Accardi*, 838 S.E.2d at 457 (making no reference to broad evidence rule or a fair market value standard, explaining that "[t]he policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense" because "[t]he value of a house is determined by considering it as a fully assembled whole, not as the simple sum of its material components"); *Henn*, 894 N.W.2d at 189 (explaining that "absent specific language in the policy, the insured does 'not pay



for a hybrid policy of actual cash value for roofing materials and replacement costs for labor,” and “[t]he property is a product of both materials and labor”); *Wilcox*, 874 N.W.2d at 784 (plaintiffs “do not advance a reasonable interpretation of the phrase ‘actual cash value’ that would categorically exclude embedded-labor-cost depreciation under every circumstance”); *Labrier*, 872 F.3d at 574 (explaining that depreciation has a “well understood meaning,” and that dictionary definitions of depreciation consistently “deduct depreciation from the initial full cost of the damaged asset, because that was the insured’s investment”); *Graves*, 686 Fed. App’x at 540 (court made no reference to broad evidence rule or market value; court reasoned that “*Black’s Law Dictionary* describes ten different depreciation methods, none of which involves distinguishing materials from labor costs. Rather, its descriptions focus on the asset itself and various approaches to determining its value as a whole. Based on the plain and ordinary meaning of ‘depreciation,’ a reasonably prudent insured would not expect the insurer to apply such an unorthodox depreciation method when determining actual cash value.”).

**E. Applying Depreciation Only to the Cost of Materials is Inconsistent With The Well-Settled Meaning of “Actual Cash Value” and Longstanding Precedent On Measuring Actual Cash Value**

Suppose, for example, that an old roof is in poor condition and has reached the end of its useful life, when it is damaged by a hailstorm. Under Plaintiff’s proposed rule, even if the insured chose not to replace the roof, the insurer would be required to pay for most of the cost of a brand new roof, notwithstanding the fact that the roof had very little economic value to the insured (given that, even if the storm had not occurred, the roof would have to be replaced very soon). This is because, under Plaintiff’s proposed rule, only the cost of the materials could be depreciated. Put another way, Plaintiff’s proposed

rule is contrary to Illinois law, and that of numerous other jurisdictions, because it would require the insurer to pay, *at the initial, ACV stage of the claim*, substantially more than the actual economic value to the insured of the damaged property. As the Tenth Circuit explained in rejecting the same argument pressed by Plaintiff here, “[b]ased on the plain and ordinary meaning of ‘depreciation,’ a reasonably prudent insured would not expect the insurer to apply such an unorthodox depreciation method when determining actual cash value.” *Graves*, 686 Fed. Appx. at 540; *see also Henn*, 894 N.W.2d at 875 (“an insured is properly indemnified when the amount calculated for actual cash value equals the depreciated value of the property just prior to the loss, which includes both materials and labor”); *Redcorn*, 55 P.3d at 1021 (explaining how principle of indemnity warranted application of depreciation to the entire value of a roof, including the labor component thereof); *Basham v. United Servs. Auto. Ass’n*, No. 16-CV-03057-RBJ, 2017 WL 3217768, at \*4 (D. Colo. July 28, 2017) (“Given the specific policy language here and background insurance principles, ‘a reasonably prudent insured would understand ‘depreciation’ to mean a decline in an asset’s overall value’”) (quoting *Graves*).<sup>5</sup>

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<sup>5</sup> The Tennessee Supreme Court is the only state supreme court that has declined to follow the majority rule and has not yet been legislatively overruled (as occurred in Arkansas). *Lammert v. Auto-Owners (Mut.) Ins. Co.*, 572 S.W.3d 170 (Tenn. 2019). The *Lammert* court ignored the ordinary meaning of “actual cash value,” failing to analyze how depreciation in the value of an asset is accurately determined. The *Lammert* court provided no support for the proposition that applying partial depreciation (only to the cost of materials) yields an *accurate* valuation of a structure, and there is none. Contrary to the *Lammert* court’s view, the Amici do not advocate a “technical definition of depreciation,” *Lammert*, 572 S.W.3d at 179, but rather the plain and ordinary meaning of depreciation as applied in numerous other contexts (as discussed further below). *Lammert* erroneously suggests that depreciation in insurance policies is intended to be different from how depreciation is applied in other property valuation contexts, when the opposite is true (as demonstrated below). Contrary to the reasoning in *Lammert*, an Illinois homeowner desiring to ascertain how depreciation works would not have to “consult a long line of case law or law review articles,” *Lammert*, 572 S.W.3d at 179 (quoting

Importantly, the fact that the insured would be entitled to only the actual value of the old roof at the initial ACV stage of the claim does *not* mean that the insured would not be able to recover the cost of replacing the old roof with a brand new roof (minus the applicable deductible) under many insurance policies sold in the marketplace. Under policies providing RCV coverage after repairs are completed, including Plaintiff's own policy, insureds may recover on a RCV basis, and thereby receive an economic gain (such as a brand new roof that would have been necessary even in the absence of a loss), simply by making the repairs. In other words, Plaintiff could have received the full cost of repair or replacement without depreciation (minus his deductible) if he made the repairs and provided evidence thereof to State Farm. *See Graves*, 686 Fed. Appx. at 539.

## **II. IN OTHER RELEVANT CONTEXTS, DEPRECIATION IS APPLIED TO THE FULL VALUE OF A BUILDING, INCLUDING BOTH LABOR AND MATERIALS**

This Court should also take into account how depreciation is applied in other contexts in which the actual economic value of a building (or portion thereof) is determined, including property tax assessments, eminent domain, and other valuations of real property. In those contexts, when the cost approach (RCV-less-depreciation) is used to estimate ACV, labor costs are *not* segregated from materials costs for purposes of applying depreciation and determining actual economic value. Rather, depreciation is applied to the total estimated RCV. To achieve consistency in Illinois law, Illinois properties should be valued for ACV insurance purposes consistently with how the same

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*Harrell v. Minn. Mut. Life Ins. Co.*, 937 S.W.2d 809, 814 (Tenn. 1996), but merely look up a basic example of how depreciation is applied to a structure in determining ACV. *See, e.g.,* Actual Cash Value Calculator available at <https://www.miniwebtool.com/actual-cash-value-calculator/> (visited Jan. 15, 2021).

properties are valued by Illinois courts for other purposes when a replacement-cost-less-depreciation method is used.

#### A. Property Tax Assessments

As in the insurance context, for purposes of property tax assessments, the cost approach to valuation (i.e., RCV-less-depreciation) is one of several methods used to value buildings. Illinois law requires that real property be valued for property tax purposes based on a percentage of its “fair cash value.” 35 Ill. Comp. Stat. Ann. 200/9-145. One of the approaches used to value real estate for property tax purposes, in some circumstances, is the cost approach, which involves estimating RCV and subtracting depreciation from the full RCV (without segregating labor costs from materials costs for purposes of depreciation as Plaintiff advocates). *See, e.g., Kendall Cty. Bd. of Review v. Prop. Tax Appeal Bd.*, 337 Ill. App. 3d 735, 737, 787 N.E.2d 363, 366 (2003) (depreciation was estimated at 3.5% per year); *Lake Cty. Bd. of Review v. Prop. Tax Appeal Bd. of State of Ill.*, 140 Ill. App. 3d 1042, 1053, 489 N.E.2d 446, 454 (1986) (depreciation estimated at 50% of RCV).

The leading treatise on property tax assessment, entitled PROPERTY ASSESSMENT VALUATION, is published by the International Association of Assessing Officers. Here is an example from that treatise regarding calculation of depreciation when using the cost approach:

$$\frac{\text{Effective age}}{\text{Total economic life}} = \frac{\text{Depreciation}}{\text{(effective age + remaining economic life)}}$$

By using the [above] formula for depreciation, what is the depreciation suffered by the following single-family residence and its corresponding improvement value if the cost new of the residence is \$400,000? The total economic life of the residence is estimated to be 50 years, and the

appraiser has determined that 5 years is the effective age for the residence.

Effective age	5 years
Divided by total economic life	50 years
<b>Equals depreciation</b>	<b>10%</b>
Cost new	\$400,000
<b>Less depreciation</b>	<b>\$40,000</b>
Improvement value	\$360,000

Garth E. Thimgan, CAE et al., PROPERTY ASSESSMENT VALUATION (International Ass'n of Assessing Officers 3d ed.) at 273 (emphasis added).

The example above could not be clearer: when using the cost approach to calculate market value, depreciation is not applied only to the cost of materials. Rather, it is applied to the *entire* RCV. There is no reason why the cost approach to valuation should be applied in a fundamentally different manner for ACV insurance purposes than it is applied for property tax valuation purposes.

#### **B. Eminent Domain and Other Real Estate Valuations**

In the context of valuing property being taken by eminent domain, under Illinois law it is “well settled that the owner of property taken for public use is entitled to that amount of compensation which will put him in as good financial condition as he was when the condemnation petition was filed.” *City of Chicago v. George F. Harding Collection*, 70 Ill. App. 2d 254, 258, 217 N.E.2d 381, 383 (Ill. App. Ct. 1965). One “perfectly acceptable theory” for valuing property for eminent domain purposes is “replacement cost less depreciation.” *Id.* at 259. The application of depreciation, however, must be true and accurate. *See id.* at 273.

Eminent domain proceedings typically involve the testimony of licensed appraisers. Persons seeking to be licensed as Illinois real estate appraisers are required to learn the cost approach along with other methods of property valuation. *See Ill. Admin.*

Code tit. 68, § 1455.370(c)(12). One of the approved course providers is the Appraisal Institute. *See* <https://www.idfpr.com/DRE/Education/ApprCourseProviderMatrix.pdf>.

The leading appraisal treatise, entitled THE APPRAISAL OF REAL ESTATE, is published by the Appraisal Institute. Here is an example from that treatise regarding calculation of depreciation when using the cost approach to determine the value of property:

The total percentage of depreciation (36%) is determined by dividing the estimated effective age of 18 years by the total economic life expectancy of 50 years (Step 2). Thus, the economic age-life formula indicates total depreciation of 36%. When this rate is applied to the cost of \$668,175, the total depreciation is \$240,543 (Step 3). The cost approach is applied as follows:

Total [replacement] cost	\$668,175
Less total depreciation	- 240,543
Depreciated cost	\$427,632
Plus land value	+180,000
Indicated value by the cost approach	\$607,632

THE APPRAISAL OF REAL ESTATE 386 (Appraisal Institute, 13th ed. 2008).

This example further demonstrates that, when using the cost approach to value property, depreciation is applied to the entire RCV of the structure. *See Wilcox*, 874 N.W.2d at 785 (citing Appraisal Institute, *The Appraisal of Real Estate* (14th ed. 2013)). This is fully consistent with the manner in which the RCV-less-depreciation methodology has been utilized for purposes of real estate assessments, eminent domain valuations, insurance adjustments and other purposes for decades. Illinois statutes and regulations require this type of depreciation methodology to be used for various purposes. *See* 65 Ill. Comp. Stat. Ann. 95/865(e)(1), (2) (Home Equity Assurance Act, providing that “[t]he program appraiser shall determine the percentage depreciation of the guaranteed residence due to failure to maintain the premises or due to physical perils or other causes not covered by the program,” and “[t]his percentage figure shall be

multiplied by the guaranteed value to determine the dollar depreciation”); Ill. Comp. Stat. Ann. 5/11-117.7.1(c) (providing for valuation of certain electric utility facilities based on replacement cost new “less depreciation computed on a straight-line basis”); 35 Ill. Comp. Stat. Ann. 200/10-600 (defining “Allowance for physical depreciation” for valuation of wind energy devices as “the actual age in years of the wind energy device on the assessment date divided by 25 years” with certain additional factors); 35 Ill. Comp. Stat. Ann. 200/10-720 (similar provision for commercial solar energy systems); 220 Ill. Comp. Stat. Ann. 5/9-210.5(c)(3) (providing for use of the cost approach in valuation of water and sewer utility property); Ill. Admin. Code tit. 89, § 140.534 (a) (requiring use of straight-line depreciation in valuing health care facilities for certain purposes).

Applying depreciation only to the materials portion of RCV would be contrary to how depreciation is applied in the context of property tax assessments and basic principles of real estate appraisal. This would mean that the same Illinois court, when applying the cost approach to valuation (i.e., RCV-less-depreciation), would value the same property in inconsistent ways, depending on whether the valuation is for purposes of a property tax assessment, real estate appraisal, or ACV insurance purposes. That would be an inefficient and nonsensical approach.

### **CONCLUSION**

Amici respectfully urge the Court to reverse the Appellate Court, and answer the certified question in the affirmative, ruling that an insurer may apply depreciation, where applicable, to the full replacement cost value of damaged property, including both the cost of materials and labor cost components.

Respectfully submitted,

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**CERTIFICATE OF COMPLIANCE**

I certify that this brief conforms to the requirements of Rules 341(a) and (b). The length of this brief, excluding the pages contained in the Rule 341(d) cover, the Rule 341(h)(1) 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 25 pages.

/s/ Michael R. Enright  
Michael R. Enright

**CERTIFICATE OF FILING AND PROOF OF SERVICE**

I certify that on January 22, 2021, I electronically filed and transmitted the foregoing **BRIEF OF AMICI CURIAE AMERICAN PROPERTY CASUALTY INSURANCE ASSOCIATION, NATIONAL ASSOCIATION OF MUTUAL INSURANCE COMPANIES AND ALLSTATE INSURANCE COMPANY** 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 transmitted a copy via SendThis File 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/ Michael R. Enright  
Michael R. Enright