No. 126446

In the
Supreme Court of Illinois

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

Reply Brief of Defendant-Appellant,
State Farm Fire and Casualty Company

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TABLE OF CONTENTS

POINTS AND AUTHORITIES

INTRODUCTION

This appeal presents the clear legal question of whether Illinois' ACV Regulation permits insurers to depreciate all components of the "replacement cost of property" (including labor) when calculating ACV where the policy itself does not define the term "actual cash value." As shown in State Farm's opening brief, the answer is decidedly yes, given the plain meaning of the ACV Regulation, application of appropriate statutory construction principles, Illinois common law regarding the meaning of ACV, and the persuasive reasoning of most state supreme courts (and two federal appellate courts) that have addressed the labor depreciation question. Plaintiff offers no effective response to these issues.

Instead, Plaintiff presents inapt contract construction arguments, including one that courts should decide the meaning of contracts based on language that *could* have been included rather than the language that was included. That argument is a slippery slope that would undermine the certainty of every contract. Moreover, Plaintiff's suggestion that State Farm is among a small minority of insurers who purportedly "chose" not to use a "labor permissive form" misstates industry practices and ignores the many labor depreciation class action lawsuits filed in Illinois and elsewhere on behalf of Illinois policyholders.

Plaintiff's arguments regarding the ACV Regulation are flawed as well. Plaintiff ignores that the ACV Regulation (i) "necessarily" was incorporated into State Farm's policy and thus supplies the definition of ACV; and (ii) does not limit the components of "replacement cost" to which depreciation may be applied.

Plaintiff instead effectively asks this Court to read additional, limiting language into the Regulation to change its meaning. Such a reading is contrary to Illinois law and would produce absurd results for property approaching the end of its useful life.

While the viability of Plaintiff's labor depreciation theory has produced conflicting results nationwide, there is no unifying theme (as Plaintiff suggests) that explains those outcomes. Nor do the different results establish that the ACV Regulation (or State Farm's policy) is ambiguous. As Plaintiff acknowledges, this Court's review is *de novo*; it is not bound by the lower courts' (or other courts') decisions. Nor is this Court's review restricted to the "reformulated" question answered by the Appellate Court, as Plaintiff erroneously contends. See *Crim by Crim v. Dietrich*, 2020 IL 124318, ¶18 ("[W]hen this court accepts an appeal *** under Rule 308, 'the scope of our review is not limited to determining whether the appellate court answered the certified questions correctly.'" (quoting *Schrock v. Shoemaker*, 159 Ill. 2d 533, 537 (1994))).

For the reasons set forth below and in State Farm's opening brief, this Court should conclude that the ACV of damaged property is properly determined by estimating the full cost to repair the damage and applying depreciation to that full amount, including any embedded labor costs.

I. Illinois' ACV Regulation Permits Labor Depreciation.

In an attempt to avoid the ACV Regulation, Plaintiff erroneously contends that the Regulation does not apply because his policy does not "explicitly" rely on

it. Pl. Br. 30 & n.17 (quoting *Clayton v. Millers First Insurance Cos.,* 384 Ill. App. 3d 429, 434-35 (2008)). That is not the law.

This Court clarified 90 years ago in *Illinois Bankers' Life Association v. Collins*, 341 Ill. 548, 552-53 (1930), that the laws in existence at the time a contract is made "necessarily" are incorporated therein. The principle articulated in the case relied upon by Plaintiff is limited to situations where the undefined policy term has no "precise legal meaning." *Clayton*, 384 Ill. App. 3d at 433. Here, however, the undefined policy term ("ACV") is *defined in the ACV Regulation*. The Regulation mandates how insurers must calculate ACV—as "replacement cost of property *** less depreciation"—and incorporates more than 100 years of Illinois jurisprudence applying that definition. See S.F. Br. 14-15.

A. Proper Statutory Construction Confirms that the ACV Regulation Unambiguously Permits Labor Depreciation.

Plaintiff argues that the ACV Regulation should be "liberally construed" in his favor in order to "protect policyholders." Pl. Br. 31. But Plaintiff does not seek a "liberal construction." He asks the Court to read words into the Regulation so as to avoid its plain meaning.

1. The Plain Meaning of the ACV Regulation Defeats Plaintiff's Argument.

Contrary to Plaintiff's contention, the goal of statutory interpretation is to ascertain and give effect to the intent of the drafter—here, the Illinois Department of Insurance ("DOI"). S.F. Br. 16, 36. That is best done by considering the plain meaning of the language. *Id.*

State Farm demonstrated in its opening brief that the plain meaning of "replacement cost of property," to which depreciation is applied, includes *all* components of replacement cost. See *id.* at 16-19 (citing *Gee v. State Farm Fire and Casualty Co.*, No. 11-CV-250, 2013 WL 8284483, at *3 (N.D. Ill. Sept. 23, 2013), and *Whitten v. Cincinnati Insurance Co.*, 189 Ill. App. 3d 90, 98 (4th Dist. 1989)). Plaintiff does not respond to this argument, which has persuaded many courts nationwide (including in Illinois) to reject the viability of Plaintiff's theory and others like it:

> "Because GCOP, sales tax, repair costs, and property value together represent the total replacement cost value, it follows naturally that GCOP, sales tax, repair costs, and property value ought to be depreciated together to reach the ACV payment." *Tolar v. Allstate Texas Lloyd's Co.*, 772 F. Supp. 2d 825, 831 (N.D. Tex. 2011).

See also, *e.g.*, *Gee*, 2013 WL 8284483, at *3 (citing *Tolar*; holding that State Farm's "application of its depreciation reduction to sales tax *along with the other components of the replacement cost calculation* is consistent with" the replacement cost less depreciation formula and "the established meaning evidenced by interpretations of similar terms" (emphasis added)); *Redcorn v. State Farm Fire and Casualty Co.*, 2002 OK 15, ¶¶13-15, 55 P.3d 1017, 1021 (rejecting labor depreciation liability theory under Oklahoma law because the cost of "replacing" property in the replacement cost less depreciation formula "necessarily includes labor").

Plaintiff does not address the Illinois Appellate Court's decision in *Whitten*, 189 Ill. App. 3d at 98-100, where the court adopted an ACV figure derived by applying 12% depreciation to the *total* estimate of replacement cost. Moreover, Plaintiff's purported distinction of *Gee* is inapt. *Gee* did not hold, as Plaintiff

suggests, that sales tax can be depreciated solely because it "attaches to the cost of materials on a percentage basis." Pl. Br. 39-40. It held that sales tax was properly depreciated because it was part of the replacement cost—just like labor here—and if it were *not* depreciated, the insured would be overcompensated. *Gee*, 2013 WL 8284483, at *2. While the court also noted that sales tax attaches to material costs on a percentage basis, *id.*, that does not help Plaintiff. *Gee* analogized sales tax to general contractor overhead and profit ("GCOP"), *id.* (citing *Goff v. State Farm Fire and Casualty Co.*, 999 So. 2d 684, 689-90 (Fla. Ct. App. 2008)), which is calculated as 20% of the total cost of materials *and labor* necessary for repairs. See *Goff*, 999 So. 2d at 690.[1] As the court recognized in *Gee*, just as GCOP is properly depreciated when it is included in the replacement cost estimate, so too is sales tax. 2013, WL 8284483, at *2. *Gee* is entirely consistent with State Farm's position.

Plaintiff's avoidance of the term "replacement cost" and singular focus on the term "depreciation" is unavailing. See Pl. Br. 29-40. Plaintiff fails to address the dictionary definitions of "depreciation" identified by State Farm (none of which separates the components of replacement cost) or any of the Illinois authorities that do not differentiate between labor and material costs when applying

[1] *Goff* refutes Plaintiff's unsupported assertion that GCOP is calculated solely "as a percentage of material costs." Pl. Br. 40 n.26.

depreciation in calculating ACV. See S.F. Br. 19-21 (citing *Whitten* and other cases).[2]

Plaintiff instead points to two decisions from the Sixth Circuit that acknowledge their departure from the majority position on labor depreciation. See *Hicks v. State Farm Fire and Casualty Co.*, 751 F. App'x 703, 710 (6th Cir. 2018) (acknowledging that the "substantial weight of authority" follows *Redcorn*); *Perry v. Allstate Indemnity Co.*, 953 F.3d 417, 423 (6th Cir. 2020) (acknowledging the contrary "majority" position).

Plaintiff's remaining cases regarding the ACV regulation are also inapt. The Tennessee Supreme Court in *Lammert v. Auto-Owners (Mutual) Insurance Co.*, 572 S.W.3d 170 (Tenn. 2019), did not interpret Tennessee's ACV regulation because it was not in effect for the plaintiff's claims. *Id.* at 178 n.6. The court relied instead on inapplicable Tennessee principles of contract interpretation. See *id.* at 178-79. And the ACV regulation in *Arnold v. State Farm Fire and Casualty Co.*, 268 F. Supp. 3d 1297 (S.D. Ala. 2017), was materially different than Illinois' regulation in that it

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[2] Plaintiff cites to dicta in *Jenkins v. State Farm Fire and Casualty Co.*, No. 15-CH-08242 (Cir. Ct. Cook Cty. Feb. 4, 2016), to assert that an Illinois court previously rejected State Farm's arguments. The *Jenkins* trial court dismissed that case as time-barred, and the appellate court affirmed without reaching the labor depreciation question. See *Jenkins v. State Farm Fire and Casualty Co.*, 2017 IL App (1st) 160612-U. Regardless, the *Jenkins* trial court misapplied the ACV Regulation by finding that ACV payments are intended to "ensure" repairs are made. S.R. 372 (10:3-5). That is what *replacement cost* payments are for. See *Higginbotham v. American Family Insurance Co.*, 143 Ill. App. 3d 398, 400 (3d Dist. 1986) (replacement cost benefits are paid only if repairs are completed).

provided *three* different methods for determining ACV. *Id.* at 1305. Moreover, the court in *Arnold* held that the regulation was not incorporated into the policy, *id.* at 1305-06, which conflicts with Illinois law. See *supra* at 3; S.F. Br. 13-15.[3]

2. Plaintiff's Argument Contravenes Basic Principles of Statutory Construction.

Plaintiff's argument ignores that courts may not read limitations into a regulation to change its meaning, *Lauer v. American Family Life Insurance Co.*, 199 Ill. 2d 384, 390-91 (2002), and that regulations must be construed to avoid absurd results. *Burger v. Lutheran General Hospital*, 198 Ill. 2d 21, 46 (2001).

State Farm demonstrated that Plaintiff's interpretation of the ACV Regulation would improperly add the following text to limit the components of "replacement cost" to which depreciation may be applied:

> "[T]he company shall determine actual cash value *** as follows: replacement cost of property at time of loss less depreciation, if any, *applied only to the materials component of replacement cost*."

See S.F. Br. 22-23 (citing cases). Furthermore, State Farm explained that Plaintiff's interpretation would produce vastly overstated ACV calculations for older properties (for example, a damaged roof nearing the end of its useful life). See *id.* at 23-24. Plaintiff ignores these points, together with the cases cited by State Farm.

[3] The reasoning in *Arnold* also conflicts with another Alabama decision holding that the replacement cost less depreciation formula "logically" permits "depreciation of the full estimated cost of repair." *Ware v. Metropolitan Property & Casualty Insurance Co.*, 220 F. Supp. 3d 1288, 1291 (M.D. Ala. 2016).

Plaintiff also misconstrues Illinois' Partial Loss Regulation, 50 Ill. Adm. Code 919.80(d)(7)(C) (2002). That regulation directs that insurers' replacement cost estimates—*as a whole*—must provide "an amount which will allow for repairs to be made in a workmanlike manner." *Id.* It does not require that *ACV payments* must enable insureds to complete repairs in a workmanlike manner. See Pl. Br. 33 n.19. Plaintiff's argument ignores the plain text of the regulation and the fact that ACV payments are addressed in the *next* section of the code, entitled "Actual Cash Value Losses." 50 Ill. Adm. Code 919.80(d)(8).

3. The ACV Regulation May Not Be Construed "Against" State Farm.

Though Plaintiff repeatedly urges the Court to construe the ACV Regulation against State Farm (see Pl. Br. 10, 34, 38-39), State Farm demonstrated that the *contra proferentem* rule "has no application" where—as here—the key policy language is supplied by statute or regulation. S.F. Br. 36 (quoting *Ramsay v. Old Colony Life Insurance Co.*, 297 Ill. 592, 598 (1921), and citing *Chicago National Life Insurance Co. v. Carbaugh*, 337 Ill. 483, 485-86 (1929)). That is because the insurer has not drafted the relevant language. *Id.*

Thus, even if the ACV Regulation were ambiguous (and it is not), the Court would not place a proverbial thumb on the scale. Rather, it would look for

evidence of the promulgating agency's intent. See *People ex rel. Madigan v. Illinois Commerce Comm'n*, 231 Ill. 2d 370, 382-83 (2008). Plaintiff ignores this argument.[4]

Plaintiff's "liberal construction" argument likewise fails. Pl. Br. 31. The ACV Regulation serves a remedial purpose, just not the one Plaintiff invents. It provides a reasonable, commonly understood definition of ACV to ensure that insurers' ACV determinations are uniform. The DOI expressly states that the purpose of Part 919 of the code is to "set forth minimum standards for the investigation and disposition of claims arising under" insurance policies. 50 Ill. Adm. Code 919.20(b) (2002). Plaintiff's strained interpretation of the Regulation should not be endorsed based on any "liberal construction" argument. See, *e.g.*, *Graves v. American Family Mutual Insurance Co.*, 686 F. App'x 536, 540 (10th Cir. 2017) (rejecting labor depreciation liability theory as based on "unorthodox" depreciation method).

4. Plaintiff Incorrectly Dismisses Evidence of the DOI's Apparent Interpretation of the ACV Regulation.

Although Plaintiff contends there is no "legal or factual support" for deferring to the DOI's apparent interpretation of the ACV Regulation, Pl. Br. 42,

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[4] While a split panel in *Hicks* suggested that Kentucky's ACV regulation "should be interpreted in favor of the insured" based on an apparent ambiguity, 751 F. App'x at 710, that holding conflicts with Illinois law. Notably, none of Plaintiff's *contra proferentum* authorities from Illinois applied the doctrine to a statute or regulation. See, *e.g., Gillen v. State Farm Mutual Automobile Insurance Co.*, 215 Ill. 2d 381 (2005) (automobile policy); *Elson v. State Farm Fire and Casualty Co.*, 295 Ill. App. 3d 1 (1998) (homeowners' policy); *National Union Fire Insurance Co. of Pittsburgh, Pennsylvania v. Glenview Park District*, 158 Ill. 2d 116 (1994) (CGL policy).

Plaintiff misunderstands the argument and fails to distinguish State Farm's cited authorities.

Simply put, the addition of "labor permissive" policy language does not change the meaning of the ACV Regulation. S.F. Br. 31. The Regulation still requires insurers to calculate ACV as "replacement cost *** less depreciation." Given DOI's statutory duty to review and approve policy language only when consistent with Illinois law, DOI logically would only approve a "labor permissive" policy if it viewed the policy as consistent with the ACV Regulation—*i.e.*, if it interpreted the "replacement cost less depreciation" formula to permit depreciation of all components (including labor) of the estimated replacement cost. *Id.* The DOI's approval of such forms, as well as forms that do not separately define "ACV," strongly suggests that it interprets the ACV Regulation like State Farm—particularly given the attention this issue has received nationwide.

Plaintiff fails to distinguish the cases State Farm cited on this issue. In *Gaston v. Founders Insurance Co.*, the Appellate Court clearly held that the DOI's non-action "against an insurance policy provision" creates an inference that the DOI "felt the provision did not violate *** the Insurance Code." 365 Ill. App. 3d 303, 319 (1st Dist. 2006). Nonetheless, Plaintiff erroneously contends that *Gaston* dealt solely with an insurance *practice*. Pl. Br. 43. Plaintiff conflates two separate issues in *Gaston*: the DOI's review of complaints regarding a claim handling practice, and the DOI's approval of policy language. The court's discussion of the

former issue (the claims practice) was unrelated to its holding as to the latter issue (the policy). See *Gaston*, 365 Ill. App. 3d at 307-08, 319.

Moreover, the Appellate Court's earlier decision in *Bernardini v. Home and Automobile Insurance Co.*, 64 Ill. App. 2d 465, 467-68 (1st Dist. 1965)—which Plaintiff simply ignores—stands for the exact same proposition as *Gaston*. Indeed, this Court cited *Bernardini* in holding that inaction by the DOI may "create an inference that the policy contains no misleading clauses." *Glazewski v. Coronet Insurance Co.*, 108 Ill. 2d 243, 251 (1985); see also *Kirk v. Financial Security Life Insurance Co.* 75 Ill. 2d 367, 376-77 (1978) (holding that, under *Bernardini*, courts "may assume" that the DOI has reviewed and approved policy language as consistent with Illinois law and recognizing that such approval "is entitled to great weight").

While Plaintiff points out that the DOI has not issued *formal* guidance regarding labor depreciation, Pl. Br. 43-44, that is no reason to disregard the "inference" created by the DOI's actions. As the amicus brief of the trade organizations makes clear, it is a common insurance industry practice to depreciate all components of replacement cost, including estimated labor costs, in calculating ACV. See APCIA, NAMIC, and Allstate Br. 4-5. The DOI is undoubtedly aware of the practice, including through the numerous labor depreciation lawsuits filed in Illinois. See *infra* at 17 n.8. Yet the DOI has never directed Illinois insurers to stop the practice and furthermore continues to use Illinois' Standard Fire Policy (the base policy to which insurers' policies must conform), which provides for payment of "ACV" without separately defining the

term. See S.F. Br. 15 n.3. The "inference" created here is material and should not be ignored.

In sum, if the plain language in the ACV Regulation is deemed inconclusive, then the Court should consider the view of the DOI—its "drafter"—when construing it. See *Madigan*, 231 Ill. 2d at 382-83.

B. State Farm is Not "Surreptitiously" Urging the Adoption of the Broad Evidence Rule in Illinois.

Plaintiff proffers a red-herring argument that State Farm is trying to "surreptitiously" convince this Court to adopt the "broad evidence rule." Pl. Br. 14-17. State Farm is doing no such thing. Plaintiff's authorities in fact confirm that State Farm's position aligns with the longstanding definition of ACV in Illinois.

At most, Plaintiff's cases simply show that Illinois courts have not generally applied a "market value" or "broad evidence" test for ACV. See, *e.g.*, *Carey v. American Family Brokerage, Inc.*, 391 Ill. App. 3d 273, 281 (1st Dist. 2009). But State Farm has not advocated for those tests, either. The "sole consideration" under the "market value" test "is what a willing buyer would give and what a willing seller would take for the property *** in a free and open market." *Id.* None of State Farm's arguments asks the Court to consider what price a property would command in the market. Similarly, while the "broad evidence" test allows for consideration of "every fact and circumstance" relating to the property's value, including "its obsolescence, both structural and functional; *** and the opinion of value given by

qualified expert valuation witnesses," *id.*, State Farm has not urged the Court here to consider such evidence.

Instead, State Farm has asked the Court to apply the plain meaning of the ACV Regulation, namely, to hold that depreciation may be applied to the "replacement cost of property"—not just to a portion of it. As support for the accusation that State Farm is "surreptitiously" advocating for a different rule, Plaintiff points to State Farm's argument that applying depreciation only to material costs would overstate ACV figures, particularly when a property is nearing or past its useful life. See S.F. Br. 10-11, 23-24; Pl. Br. 16. But State Farm's argument has nothing to do with market value or broad evidence. Instead, it simply highlights the logical flaw in Plaintiff's position: that a 30-year-old roof constructed with 20-year shingles would have an ACV of at least 60% of the full cost of a *brand-new* roof. S.F. Br. 23-24.

Importantly, the Illinois authorities that Plaintiff cites demonstrate that the plain meaning of "depreciation" in the replacement cost less depreciation formula accounts for the *exact same considerations* flagged by State Farm:

> "Depreciation 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*." (Emphasis added.) *Carey*, 391 Ill. App. 3d at 281.

Plaintiff's extensive reliance on *Dickler v. CIGNA Property and Casualty Co.*, 957 F.2d 1088 (3d Cir. 1992), is misplaced. See Pl. Br. 16-17. The court in *Dickler* (applying New York law) merely held that the replacement cost less depreciation

formula precluded deductions for "economic obsolescence," *i.e.*, the "loss in value caused by economic or other conditions which are 'external' from the property itself." *Id.* at 1100. State Farm has not argued for any such deductions here. Rather, State Farm has maintained that the ACV Regulation permits applying depreciation to the full "replacement cost of property."

II. State Farm's Policy is Not Ambiguous.

Plaintiff's contractual ambiguity argument ignores that (i) the DOI must "order" insurers to "discontinue" the use of any policy form that it finds is ambiguous, S.F. Br. 30 (quoting 215 ILCS 5/143(2) (1975)); (ii) the DOI never ordered State Farm to discontinue the use of Plaintiff's policy form; and (iii) Illinois' Standard Fire Policy uses the term "ACV" without separately defining it. S.F. Br. 15 n.3. These facts, together with Plaintiff's failure to offer a definition of ACV *other* than replacement cost less depreciation, Pl. Br. 17, defeat Plaintiff's position. See S.F. Br. 16 n.4.[5]

Plaintiff's remaining arguments are likewise without merit.

A. The Court Should Not Interpret the Policy Based on Language State Farm *Could Have* Included.

Plaintiff contends that because State Farm supposedly "could have" added policy language specifically permitting labor depreciation, the absence of such language renders the policy ambiguous. Pl. Br. 18-21. That argument is generally

[5] While Plaintiff repeatedly argues that State Farm failed to define the "policy term 'depreciation,'" *e.g.*, Pl. Br. 21, that word *does not even appear* in the structural damage portion of the policy. See A.276.

untenable, for it could be used to find ambiguity in virtually *every* contract. See, *e.g.*, *U.S. Fire Insurance Co. v. Charter Financial Group, Inc.*, 851 F.2d 957, 962 (7th Cir. 1988) ("It is true that USFIC could have used clearer language *** That the language was imperfect, however, does not render the policy ambiguous."); *Obenland v. Economy Fire & Casualty Co.*, 234 Ill. App. 3d 99, 107-08 (1st Dist. 1992) (holding that attempt to "improve" policy language does not suggest original language was ambiguous), *aff'd*, 191 Ill. Dec. 158 (1993); *Paul v. State Farm Mutual Automobile Insurance Co.*, No. 1:13-CV-2405, 2014 WL 1116979, at *6 (N.D. Ohio Mar. 19, 2014) ("An unambiguous term is not rendered ambiguous *** because the insurance companies could have used more precise language."), *aff'd*, 595 F. App'x 605 (6th Cir. 2015).

As explained below, Plaintiff's use of other policy language and his discussion of supposed industry practice fail to establish any ambiguity here.

1. Language in Other Policies Cannot Create Ambiguity.

Plaintiff first asserts that State Farm "chose" not to endorse his policy with its endorsement (FE-3650) that explicitly defines ACV to include labor depreciation. Pl. Br. 7. But that endorsement did not begin to take effect in Illinois until February 1, 2016, S.R. 1046, ¶18, after Plaintiff's loss. S.R. 11.

State Farm's subsequent endorsement has no bearing on whether Plaintiff's policy is ambiguous. When policy language is revised, the revised language is "irrelevant to whether the clause as originally written was ambiguous." *Obenland*, 234 Ill. App. at 107; see also *Pastor v. State Farm Mutual Automobile Insurance Co.*,

487 F.3d 1042, 1045 (7th Cir. 2007) ("[T]o use *** a revision in a contract to argue the meaning of the original version would *** discourage[] efforts to clarify contractual obligations[.]").

Similarly, Plaintiff cannot create ambiguity by relying on *other* insurers' policies. See, *e.g.*, *Paul*, 2014 WL 1116979, at *6 ("Plaintiffs cannot create ambiguity *** by pointing to other insurance policy language that they deem to be more clear."); *Ekco Group, Inc. v. Travelers Indemnity Co. of Illinois*, 273 F.3d 409, 415 (1st Cir. 2001) ("narrowed definition" in sample policy form could not create ambiguity because "expression can always be made clearer").[6]

Plaintiff does not cite any case deeming policy language ambiguous simply because another insurer's policy was clearer. Plaintiff relies on *Gillen*, *Hicks*, and *Arnold*, but each court found ambiguity based on an analysis of the policy language *at issue in the case*, not language from other policies. See *Gillen*, 215 Ill. 2d at 395-96; *Hicks*, 751 F. App'x at 708-09; *Arnold*, 268 F. Supp. 3d at 1305. And Plaintiff's remaining cases *did not find* ambiguity. See *Glenview Park District*, 158 Ill. 2d at 122-23; *Illinois Insurance Guaranty Fund v. Nwidor*, 2018 IL App (1st) 171378,

[6] Although Plaintiff suggests that other Illinois insurers have long used "labor permissive forms," Pl. Br. 3, the forms he references were not filed with the DOI until 2013, 2014, and 2015, respectively. See S.R. 391-92; S.R. 499 (SERFF Tracking No. CFPC-129004679, at 3, available at https://filingaccess.serff.com/sfa/home/IL ("Download Zip File" button at end of the filing summary)); S.R. 431-51 (SERFF Tracking No. SHEL-129374634, at 3); S.R. 452-98 (SERFF Tracking No. FARM-129881973, at 4). State Farm filed its FE-3650 endorsement with the DOI in 2015. See SERFF Tracking No. SFMA-130249845, at 2.

¶¶33-34.[7] Moreover, even if State Farm's policy were deemed ambiguous, there *still* would be no basis to review other insurers' policies because they would provide no evidence of State Farm's or Plaintiff's intent in entering into the policy. See *Farm Credit Bank of St. Louis v. Whitlock*, 144 Ill. 2d 440, 447 (1991) (holding that extrinsic evidence is admissible, if a contract is ambiguous, only to explain what the *contracting parties* intended).

2. Plaintiff's Purported "Industry" Position on Labor Depreciation Does Not Establish Ambiguity.

Plaintiff (and his amicus, United Policyholders) inaccurately paint State Farm as a "lone wolf" applying labor depreciation against a contrary, industry-wide position. Plaintiff's assertion is belied by the dozens of lawsuits nationwide challenging the labor depreciation practices of many of the largest insurers. Many of those lawsuits (filed in Illinois and elsewhere) involve asserted *Illinois* classes and were filed by the same lawyers representing Plaintiff here.[8]

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[7] Plaintiff's presentation of the quote from *Nwidor* (Pl. Br. 19) is misleading. The surrounding text in *Nwidor* reveals that the court was reaffirming the rule that courts should interpret the language that appears in the policy rather than rewriting it. See 2018 IL App (1st) 171378, ¶34. The court in *Nwidor* was *not* suggesting—as Plaintiff implies—that courts should determine the meaning of disputed language by looking at language that the insurer presumably "could have" included.

[8] A small sampling of those lawsuits includes: *Hester v. Allstate Vehicle and Property Insurance Co.*, No. 20-L0462 (Cir. Ct. St. Clair County, June 12, 2020); *Thaxton v. Allstate Indemnity Co.*, No. 2020-L-000908 (Cir. Ct. Madison County, July 2, 2020); *Staunton Lodge No. 177, A.F. & A.M. v. Pekin Insurance Co.*, No. 2020-L-001297 (Cir. Ct. Madison County, Sept. 10, 2020); *Goble v. Trumbull Insurance Co.*, No. 2:20-cv-05577 (S.D. Ohio Oct. 26, 2020); *Readinger v. Liberty Mutual Personal*

Although the rash of labor depreciation class litigation only began in 2013, that is not because industry practice changed. It is because, in November 2013, the Arkansas Supreme Court became the first court to suggest that labor depreciation was improper. See *Adams v. Cameron Mutual Insurance Co.*, 2013 Ark. 475, 5, 430 S.W.3d 675, 678 (2013). The *Adams* decision launched a flurry of lawsuits against insurers. Previously, only one state supreme court had directly addressed labor depreciation in the calculation of ACV—and had found the practice unambiguously *permitted*. See *Redcorn*, 2002 OK 15, ¶15, 55 P.3d 1017, 1021.

Plaintiff's effort to paint a different historical picture falls flat. Other than the isolated comments of two individual insurance examiners in Ohio and California, see Pl. Br. 41 n.27, Plaintiff's only "source" is a 2013 article that itself does not cite any sources in declaring that labor costs historically were not depreciated. See Pl. Br. 5 (citing Don Wood *et al.*, *Insurance Recovery After Hurricane Sandy: Correcting the Improper Depreciation of Intangibles Under Property Insurance Policies*, in 42 Torts, Ins. & Compensation L.J. 19 (Winter 2013)). Notably, the Nebraska Supreme Court reviewed these same materials and concluded that they "fail to support the premise of any *** historical practice" by insurers of not depreciating labor. *Henn v. American Family Mutual Insurance Co.*, 295 Neb. 859,

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Insurance Co., No. 2:20-cv-06027 (S.D. Ohio Nov. 23, 2020); *American Legion Post # 118 v. Illinois Casualty Co.*, No. 4:21-cv-04018-SLD-JEH (C.D. Ill. Feb. 5, 2021); *Wills v. AmGUARD Insurance Co.*, No. 3:21-cv-00189-SMY (S.D. Ill. Feb. 18, 2021); and *Danshir, LLC et al. v. Greater New York Mutual Insurance Co.*, No. 1:21-cv-01158-RRP (N.D. Ill. Mar. 1, 2021).

876, 894 N.W.2d 179, 190 (2017); see also Brief of Plaintiff Henn, *Henn*, No. S-16-597, 2016 WL 4574506, at *9-10 (Neb. 2016) (discussing the same sources cited by Plaintiff).

In fact, actual historical insurance texts—including those discussed in the trade organization's amicus brief—refute Plaintiff's narrative. See APCIA, NAMIC, and Allstate Br. 14-15. Even the slightly older reference materials submitted by Plaintiff's amicus demonstrate that the correct method for applying depreciation under the "replacement cost less depreciation" formula is to apply it to *all* components of replacement cost. For example, one article opines that to account for 30% depreciation to a damaged structure, ACV should be calculated by applying 30% depreciation to the *full* $120,000 replacement cost. UP Br., Appx. at A7 (excerpt from M. McCracken, *What Exactly is Actual Cash Value? Better Yet, How Do You Calculate It?*, in Int'l Risk Mgmt. Inst., Inc. (Dec. 2007)).

Plaintiff's argument regarding historical industry practice is unpersuasive and does not create ambiguity in Plaintiff's policy.[9]

B. Illinois Law Does Not Support Plaintiff's "Full Cost to Restore" Interpretation of ACV.

Relying exclusively on *non-Illinois* authorities, Plaintiff argues that ACV coverage is "intended to return the policyholder's *building* to the same condition it

[9] Plaintiff's discussion regarding depreciation settings within Xactimate (Pl. Br. 4-5)—based on an embellishment of State Farm's answer—has nothing to do with whether the ACV Regulation (or State Farm's policy) is ambiguous.

was in right before the loss." (Emphasis added.) Pl. Br. 11-12. Plaintiff's phrasing is deliberate. The two cases on which he relies most heavily specifically recognized this interpretation of ACV as reasonable and, as a result, found the term ACV to be ambiguous under Mississippi and Kentucky law, respectively. See *Mitchell v. State Farm Fire and Casualty Co.*, 954 F.3d 700, 706 (5th Cir. 2020); *Hicks*, 751 F. App'x at 706, 709.

Illinois law, however, does not support Plaintiff's advocated interpretation of ACV. Illinois courts recognize that "[p]roperty insurance is not insurance on the property itself, but rather on the interest of the person insured." *Paluszek v. Safeco Insurance Co. of America*, 164 Ill. App. 3d 511, 516 (1st Dist. 1987); *accord Spirit of Excellence, Ltd. v. Intercargo Insurance Co.*, 334 Ill. App. 3d 136, 148 (1st Dist. 2002). In other words, in the case of a fire, the policy does "not insure the dwelling which was destroyed by fire," but rather insures the policyholder "against all direct pecuniary loss which she might sustain by reason of its destruction." *Patterson v. Durand Farmers Mutual Fire Insurance Co.*, 303 Ill. App. 128, 137 (2d Dist. 1940).

Moreover, under policies like Plaintiff's, where covered losses are settled in two steps—ACV first and replacement cost second—Illinois courts have consistently held that costs associated with repairs are not owed until *after repairs are completed*. S.F. Br. 26-28. The reason is that, until repairs are completed, the policyholder has not suffered a "direct pecuniary loss" attributable to repair costs. See *Patterson*, 303 Ill. App. at 137. It follows that a payment of repair costs pre-

repairs (*i.e.*, as ACV) "would result in a net profit to the insured," contrary to the principle of indemnity. *Paluszek*, 164 Ill. App. 3d at 516.

Plaintiff's argument—that full labor costs associated with repairs should be paid at the ACV stage—seeks to avoid Illinois law. Moreover, while Plaintiff purports to rely on an insurance treatise as support, Pl. Br. 12, the treatise likewise makes clear that ACV payments are designed to place the *insured* "in the same *financial* condition as the insured would have been in if there had been no [loss]," not to place her *property* in the same *physical* condition it would have been in if there had been no loss. Steven Plitt, *et al.*, Couch on Insurance §175.5 (3d ed. 2020).

In effect, Plaintiff asks this Court to convert his policy into a hybrid policy such that, immediately after a loss, ACV is paid for materials and replacement cost is paid for labor. But that is not what he purchased. His policy provides for payment of full replacement cost—including materials, labor and all other components of replacement cost—at step *two*, not at step one. Courts following the majority approach to the labor depreciation issue have pointed to this exact issue in rejecting Plaintiff's liability theory. See S.F. Br. 27-28.

III. Plaintiff Fails to Distinguish the More Persuasive Labor Depreciation Decisions.

As demonstrated in State Farm's opening brief, the reasoning from the decisions allowing labor depreciation is consistent with Illinois law. See S.F. Br. 24-31. Plaintiff does not address that reasoning. Instead, he urges this Court to adopt the dicta "harmonizing" analysis offered by the Sixth Circuit majority in the

unpublished *Hicks* decision. See Pl. Br. 23-25. Citing *Hicks*, Plaintiff argues that the cases show that "ACV" can purportedly be construed to bar labor depreciation whenever it is defined as "replacement cost less depreciation," and that only jurisdictions following the "broad evidence" rule permit labor depreciation. See Pl. Br. 24-25 (citing *Hicks,* 751 F. App'x at 708-11). Not so.

In fact, the dicta Plaintiff touts raises a "distinction without a difference." *Hicks*, 751 F. App'x at 714 (Griffin, J., dissenting). The reason is that the cases deeming "labor depreciation" permissible either involve state law defining ACV as "replacement cost less depreciation," a policy so defining ACV, or an insurer that used that calculation method as permitted under governing law. See, *e.g.*, *Accardi v. Hartford Underwriters Insurance Co.*, 373 N.C. 292, 293-94, 838 S.E.2d 454, 455-56 (2020) (policy definition); *In re State Farm Fire and Casualty Co. ("LaBrier")*, 872 F.3d 567, 576 (8th Cir. 2017) (calculation method); *Graves*, 686 F. App'x at 539-40 (policy definition); *Papurello v. State Farm Fire and Casualty Co.*, 144 F. Supp. 3d 746, 768 (W.D. Pa. 2015) (common law).

Plaintiff's case chart (Pl. Br. 23) is also misleading. For example, Plaintiff counts two Arkansas decisions as favoring policyholders, yet fails to note that they were superseded four years ago. See *Sproull*, 2020 IL App (5th) 180577, ¶ 38 (noting that *Adams* was superseded by Ark. Code § 23-88-106(a)(2) (2017)). Similarly, Plaintiff counts the Sixth Circuit's decisions in both *Perry* and *Cranfield*, even though *Cranfield* was a *per curiam* decision in which the panel was bound by *Perry*. See *Cranfield v. State Farm Fire and Casualty Co.*, 798 F. App'x 929, 930 (6th Cir. 2020).

Plaintiff also mischaracterizes *Accardi* as a "broad evidence" decision when that case does not mention "broad evidence." See *Accardi*, 373 N.C. at 295-97, 838 S.E.2d at 456-58. Finally, Plaintiff simply omits the Minnesota Supreme Court's decision in *Wilcox v. State Farm Fire and Casualty Co.*, 874 N.W.2d 780, 784 (Minn. 2016), even though it found ACV *unambiguous* and rejected the plaintiff's theory that ACV "categorically exclude[s] embedded-labor-cost depreciation." *Id.*[10]

Plaintiff's extended discussion of an appraisal process (Pl. Br. 46-48) is likewise unavailing, for appraisal is not at issue here and provides no basis for distinguishing *LaBrier* or *Wilcox*; neither case dealt with an appraisal process.

In sum, Plaintiff offers no reason for this Court not to follow the more persuasive labor depreciation decisions identified by State Farm.

CONCLUSION

Defendant-Appellant State Farm Fire and Casualty Company respectfully requests that this Court answer the certified question in the affirmative.

Dated: March 29, 2021

Respectfully submitted,

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[10] The partial dissenting opinion in *Perry* (also not reflected on Plaintiff's chart) lists *Wilcox* as among the decisions that "followed *Redcorn*'s lead." *Perry*, 953 F.3d at 431 (Readler, J., concurring in part and dissenting in part).

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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 or words contained in the Rule 341(d) cover, the Rule 341(h)(1) 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 6,000 words.

BY: */s/ Joseph A. Cancila, Jr.*

CERTIFICATE OF FILING AND PROOF OF SERVICE

I certify that on March 29, 2021, I caused the foregoing Brief of Defendant-Appellant to be electronically filed with the Clerk of the Court of the Illinois Supreme Court by using the Odyssey eFileIL system.

I further certify that the other individuals in this case named below have been served by transmitting a copy via email to the addresses designated by those individuals, on March 29, 2021.

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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.

BY: */s/ Joseph A. Cancila, Jr.*