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Can Labor Be Depreciated In Actual Cash Value Calculations?

By **Tracey Jordan** (December 6, 2017, 2:26 PM EST)

Courts continue to split on the issue of whether labor can be depreciated when calculating actual cash value (ACV) payments under property policies. The split occurs regardless of whether the policies contain a definition of ACV or lack such a definition. Accordingly, insurance companies should be aware of the jurisdiction in which the loss occurs and whether recent case law has definitively determined whether labor can be depreciated.



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The seminal case upon which many courts use as a guide when deciding the issue of labor depreciation in an ACV calculation is *Redcorn v. State Farm & Cas. Co.*^[1] In *Redcorn*, the Oklahoma Supreme Court reasoned that depreciation of labor was appropriate under the broad evidence rule, which encompasses many different components in ascertaining ACV, including the age of the property, market value, condition of the property or the property's tax value. The policy at issue provided for ACV as the full measure of recovery, but did not define ACV. The court concluded that the term ACV "has a specific meaning that has been construed by this Court, and is not ambiguous."^[2] In reaching its conclusion that the insured would be adequately indemnified if labor was depreciated, the court noted that labor was not able to be separated from the total depreciated amount because:

[a] roof does not have a separate market value from the building it covers. The relevant evidence for determining actual cash value for a roof would include cost of reproduction, the age of the roof, and the condition in which it has been maintained. A building is the product of both materials and labor... Likewise, a roof is the product of materials and labor, and its age and condition are also relevant facts in setting the amount of a loss.^[3]
^[4]

Accordingly, the court held that "indemnity is served by considering the age and condition of the roof, both materials and labor, in setting an amount of loss."^[5] Otherwise, the court expressed that the policy holder would be unjustly enriched because the policy holder did not pay for a hybrid policy of ACV for the roof and replacement cost for the materials.^[6]

Redcorn was a 5-3 decision, with the dissent arguing that a roof is not an integrated product, but instead is a combination of products in the form of shingles and services in the form of labor.^[7] Thus, the dissent disagreed that an insured would be overindemnified contending that depreciating labor "does not logically tend to establish the correct estimate of the actual cash value of the roof at the time of loss" as required by the broad evidence rule.^[8]

Since the *Redcorn* decision, courts throughout the country have continued to grapple with issue of whether of labor can be depreciated when calculating ACV payments, with many courts citing the majority as a basis for allowing labor to be depreciated and many courts citing the dissent as a basis for not permitting labor to be depreciated. These decisions can generally be classified as those in which the insurance policies at issue do not provide a definition of ACV and those in which the insurance policies at issue do provide such a definition.

Court Decisions with Policies that Contain No Definition of ACV

In the last few years, several courts have held that labor should be depreciated when determining the ACV payment to an insured after a loss even though ACV is not defined in the insurance policy.

For example, in *Papurello v. State Farm Fire & Cas. Co.*,^[9] the policy at issue did not define ACV, but provided a two-step indemnification provision in which the insured is only entitled to ACV at the time of the loss until such time as repairs or replacement is completed. The United States District Court for the Western District of Pennsylvania predicted that the Pennsylvania Supreme Court would conclude that the insurer did not breach the insurance policy by including tax and labor costs in estimating replacement costs from which depreciation was deducted to arrive at an ACV payment to the insured.^[10] The court reasoned that if labor was not depreciated, the insured would "impermissibly" receive full replacement cost prior to the completion of the repairs after the loss.^[11]

In *Wilcox v. State Farm Fire and Cas. Co.*,^[12] the Minnesota Supreme Court answered the following certified question from the United States District Court for the District of Minnesota regarding depreciation of labor:

When a homeowner's insurance policy does not define the term "actual cash value," may an insurer depreciate the cost of labor in determining the "actual cash value" of a covered loss when the estimated cost to repair or replace the damaged property includes both materials and embedded labor components?^[13]

The court answered the certified question in the affirmative with the caveat that "the trier of fact may consider embedded-labor-cost depreciation when such evidence logically tends to establish the actual cash value of a covered loss" as labor cost "is only one of many factors to be considered by the trier of fact; and its relevance depends on the facts and circumstances of the particular case."^[14] Thus, the court acknowledged the flexible broad evidence rule "in order to effectuate indemnity in the fairest manner..."^[15]

Similarly, the court in *Henn v. Am. Family Mut. Insurance Co.*,^[16] addressed a policy that provided for ACV payment as the first step following a loss, but the policy provided no definition of ACV. The Supreme Court of Nebraska disagreed with the Redcorn dissent "that the depreciation of labor is illogical because labor does not depreciate."^[17] Instead, the court adopted the reasoning of the Redcorn majority by noting that Nebraska has also adopted the broad evidence rule which allows all relevant facts and circumstances to be considered when determining ACV following a loss.^[18] The court noted that, as in *Redcorn*, this court may consider any relevant evidence in its calculation of actual cash value, including materials and labor. We agree with the majority opinion in *Redcorn*, in 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." The property is a product of both materials and labor.^[19]

Finally, the Eighth Circuit in the recent decision of *In re State Farm Fire and Cas. Co.*^[20] agreed with the reasoning of the court in *Wilcox* and decided that the Missouri Supreme Court would likewise conclude that the issue of determining ACV must take into consideration all of the facts surrounding the loss, including labor-cost depreciation. Accordingly, the court concluded that "although we do not rule out the possibility that State Farm's use of Xactimate estimating methodology would produce an unreasonable estimate of the actual cash value of some partial losses, this issue may only be determined based on all the facts surrounding a particular insured's partial loss."^[21]

Despite the holdings in the cases above, several jurisdictions have not permitted depreciation of labor when calculating ACV payments to an insured when ACV is not defined in the insurance policy. For example, the United States District Court for the Eastern District of Kentucky in *Bailey v. State Farm Fire and Cas. Co.*^[22] also adopted the reasoning of the Redcorn dissent by finding it "more persuasive" noting that "[t]he very idea of depreciating labor defies good common society."^[23]

The Arkansas Supreme Court in *Adams v. Cameron Mut. Insurance Co.*^[24] also found the dissent in *Redcorn* "more convincing," concluding that labor should not be depreciated "when determining the actual cash value of a covered loss under an indemnity insurance policy that does not define the term 'actual cash value.'"^[25] And, since the decision in *Adams*, the Arkansas Supreme Court in *Shelter Mut. Insurance Co. v. Goodner*^[26] became the first court to hold that, as a matter of public policy, labor cannot be depreciated when calculating the ACV of a property damage claims, regardless of the policy language used.

Finally, the United States District Court for the Southern District of Alabama in *Arnold v. State Farm Fire and Cas. Co.*^[27] denied a motion to reconsider an earlier decision^[28] in which the court

concluded that "a reasonable insured, armed only with the Policy language and everyday meaning of the words used, could reasonably understand that ACV does not encompass depreciation of labor costs."

Court Decisions with Policies that Contain A Definition of ACV

In addition to the cases that discuss and reach opposite conclusions when insurance policies fail to define ACV, courts also have split when policies provide a definition. In *Riggins v. American Family Mut. Insurance Co.*,^[29] the United States District Court for the Western District of Missouri addressed the depreciation of labor with a policy defining ACV to include depreciation "for physical deterioration and obsolescence." The court held that the definition "limits the type of depreciation that may be factored into a calculation of 'actual cash value []'" finding that depreciation applied to the entire estimated costs of repair which included labor was improper.^[30]

Despite the holding in *Riggins*, two other recent decisions have permitted the depreciation of labor with similar definitions. Specifically, in *Graves v. American Family Mut. Ins. Co.*,^[31] the Tenth Circuit addressed depreciation of labor under a policy which defined ACV as "the amount which it would cost to repair or replace damaged property with property of like kind and quality, less allowance for physical deterioration and depreciation, including obsolescence." The court rejected the dissent in *Redcorn* finding that there is "no reason to dissect depreciation into separate components of materials and labor costs in the first instance."^[32] Accordingly, the court concluded that "a reasonably prudent insured would not expect the insurer to apply such an unorthodox depreciation method [of distinguishing materials from labor costs] when determining actual cash value."^[33]

Similarly, the United States District Court for the District of Colorado in *Basham v. United Services Automobile Assoc.*^[34] permitted the depreciation of labor when ACV is defined in the policy. There, the policy defined ACV as "the amount it would cost to repair or replace covered property at the time of loss or damage with material of like kind and quality subject to a deduction for deterioration, depreciation and obsolescence."^[35] The court held that USAA did not impermissibly depreciate labor costs in determining actual cash value of the loss based upon the specific policy language because "a reasonably prudent insured would understand 'depreciation' to mean a decline in an asset's overall value."^[36]

Conclusion

As is evident from the case summaries, depreciation of labor continues to be a hot-topic, divisive issue. Regardless of whether ACV is defined in the policy, some courts have determined that labor can be depreciated in an ACV calculation, while other courts have decided that labor cannot be depreciated. Based upon the lack of consensus and the recent glut of litigation on the topic, insurance companies should be aware of law in the jurisdiction in which they are calculating losses to avoid any adjustment pitfalls, and perhaps future litigation regarding the topic.

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[1] 55 P.3d 1017 (Okla. 2002).

[2] *Id.* at 1019.

[3] *Id.* at 1020.

[4]

[5] *Id.* at 1021.

[6] *Id.*

- [7] Id. at 1022.
- [8] Id. at 1022-23.
- [9] 144 F.Supp.3d 746, 759 (W.D. Pa. 2015).
- [10] Id. at 770.
- [11] Id.
- [12] 874 N.W.2d 780 (Minn. 2016).
- [13] Id. at 782.
- [14] Id. at 785.
- [15] Id.
- [16] 295 Neb. 859, 862 (2017)
- [17] Id. at 873.
- [18] Id.
- [19] Id. at 874-75.
- [20] 872 F.3d 567, 577 (8th Cir. 2017).
- [21] Id.
- [22] 2015 WL 1401640 (E.D. Ky. March 25, 2015).
- [23] Id. at *8.
- [24] 2013 Ark. 475, 430 S.W.3d 675 (2013).
- [25] Id. at 679.
- [26] 2015 Ark. 460, 2015 WL 8482788 (Ark. Dec. 10, 2015).
- [27] 2017 WL 5451749 (S.D. Ala. Nov. 14, 2017).
- [28] --- F.Supp.3d ---, 2017 WL 33308990, *11 (S.D. Ala. Aug. 30, 2017).
- [29] 106 F.Supp.3d 1039 (W.D. Mo. March 27, 2015).
- [30] Id. at 1041.
- [31] 686 Fed.Appx. 536, 537 (10th Cir. 2017).
- [32] Id. at 540.
- [33] Id.
- [34] 2017 WL 3217768 (D. Col. July 28, 2017).
- [35] Id. at *1.
- [36] Id. at *4, citing *Graves*, 2017 WL 1416278, at *4.

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