

May 30, 2025

Attn: Kathryn Callahan
Director of Regulatory Policy
Maryland Insurance Administration
200 St. Paul Place
Suite 2700
Baltimore, Maryland 21202
Via email: kathryn.callahan1@maryland.gov.

RE: Draft Bulletin: "Depreciation of Labor for Claims Settled on an Actual Cash Value Basis"

Dear Ms. Callahan,

APCIA appreciates the opportunity to provide comments to the Maryland Insurance Administration (MIA) proposed Bulletin "Depreciation of Labor for Claims Settled on an Actual Cash Value Basis" (the "Bulletin"). The American Property Casualty Insurance Association (APCIA) is a national trade organization whose members write approximately 67.1% of the homeowners insurance market in Maryland.

The MIA proposed Bulletin states that the practice of depreciating labor and other non-tangible items constitutes an unfair claim settlement practice in violation of Subtitle 27 of the Maryland Insurance Article. §27-304(6).

APCIA and its members respectfully disagree with the Bulletin's conclusions and wish to assert that calculation of actual cash value (ACV) to include labor depreciation is equitable to both insured and insurer.

We are concerned that MIA's position that it will not approve any policy language that allows for depreciation of labor and will require any previously approved language to be removed from the policy within 90 days is detrimental to consumers and the insurance market in Maryland.

We appreciate the opportunity to share the following concerns with the MIA.

The Economic Value of Property Is A Byproduct of Both the Materials and Embedded Labor That Go into Making the Finished Product.

The Bulletin fails to recognize that the value of property is a byproduct of both the labor and materials that go into making a finished product – whether that be an item of personal property or the roof on an insured's home. The material and labor components that make up a property's economic value are necessarily intertwined. They cannot be separated when calculating depreciation without artificially overstating the value of damaged property.

While Maryland courts have not directly addressed the issue raised by the proposed Bulletin, numerous courts in other jurisdictions, including the state supreme courts of both North and South Carolina, have held that depreciating labor costs is appropriate. As the North Carolina Supreme Court explained, “[t]he policy language provides no justification for differentiating between labor and materials when calculating depreciation, and to do so makes little sense.” *Accardi v. Hartford Underwriters Ins. Co.*, 838 S.E.2d 454, 457 (N.C. 2020). This is 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.” *Id.*

Similarly, the South Carolina Supreme Court explained that “the market has one price for [a] roof because the materials and labor costs are ‘embedded’ in it;” “[t]hus, when a typical homeowner replaces a roof, she pays for the roof as one unit.” *Butler v. Travelers Home & Marine Ins. Co.*, 858 S.E.2d 407, 411 (S.C. 2021). “[I]t makes no sense for an insurer to include depreciation for materials and not for embedded labor.” *Id.*

Courts from other jurisdictions have also long recognized that actual cash value means the actual economic value of the property at the time of loss. See *Butler* at 409. (“ACV is what the structure was worth at the time it was damaged”); see also, e.g., *Tyler v. Shelter Mut. Ins. Co.*, 184 P.3d 496, 501 (Okla. 2008) (actual cash value means “the actual value of property expressed in terms of money”); *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”); *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”).

Maryland’s highest court has recognized that “[t]he definition of depreciation is, of course, well recognized: ‘Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year.’” *Pub. Serv. Comm’n of Maryland v. Baltimore Gas & Elec. Co.*, 329 A.2d 691, 700 (Md. 1974). [Citing: *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 167, 54 S.Ct. 658, 664-665, 78 L.Ed. 1182, 1192-1193 (1934).]

When the economic value of a building or other physical asset decreases, it is not limited to a decrease in value of the materials. Rather, it is the **total economic value of the property** that declines as the property’s physical condition deteriorates over time through wear, tear, and obsolescence. Therefore, applying depreciation to the total economic value (i.e., the materials and the embedded labor) accurately restores the insured to the position they were in prior to the loss.

Our members wish to remind MIA that their definitions of ACV have been drafted to eliminate any ambiguity and specifically allow for the depreciation of labor in the calculation of ACV and to ensure fair and transparent product offerings to their customers. Many of these definitions have been approved by majority insurance departments in the states in which they have been filed, including approval in MD, demonstrating overwhelming support for the method of calculation.

In other relevant contexts, such as Property Tax Assessments, Real Estate Appraisals, Eminent Domain and other valuations, depreciation is also consistently applied to the full economic value of a property, including both labor and materials, because it is a fair and accurate measure for estimating the economic value of property. Conversely, when depreciation is applied only to

materials as the MIA urges, a property's economic value is artificially inflated, and an insured is placed in a better financial position than before the loss.

Depreciating the Full RCV Fairly and Equitably Reflects the Economic Value of the Damaged Property Immediately Before the Loss Occurred.

The proposed Bulletin also seems to misconstrue when RCV coverage is available under most RCV policies. For example, the Bulletin states that the practice of depreciating labor contradicts the "purpose of property insurance – to restore the insured to the approximate financial position they were in prior to a covered loss – by unfairly shifting significant responsibility for labor repair costs to the insured." However, under the terms of most RCV policies, an insured is not entitled to receive the cost of repairing or replacing damaged property until the work is performed and the costs are incurred. Rather, an insured is first entitled only to receive the ACV of the damaged property. The insured may then recover the RCV of the damaged property if, and when, the damaged property is repaired or replaced.

Under this two-step valuation framework, the initial ACV payment is intended to indemnify the insured for their actual economic loss, not to pay for the costs to repair or replace the property. As the U.S. Court of Appeals for the 8th Circuit explained in *In re State Farm Fire & Cas. Co.*, 872 F.3d 567, 573 (8th Cir. 2017):

The basic premise of traditional property insurance is the concept of indemnity. The 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. Policies that provide this level of coverage are universally known as actual cash value policies. See, e.g., *Travelers Indem. Co. v. Armstrong*, 442 N.E.2d 349, 352 (Ind. 1982); 12 Couch on Insurance § 175.5 (3d ed. 2005 & 2017 Supp.). 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.' *Daggs v. Orietn Ins. Co. of Hartford*, 136 Mo. 382, 38 S.W. 85, 87 (1896), *aff'd*, 172 U.S. 557, 19 S.Ct. 281, 43 L.Ed. 552 (1899).

To calculate the ACV of property, the insurance industry uses the "replacement cost less depreciation" formula. Under this formula, which is widely accepted, an insurer first estimates the RCV of the damaged property and then applies a reasonable amount of depreciation based on factors such as the age, condition, obsolescence and useful life of the property. This formula fairly and equitably reflects the economic value of the insured's loss before making repairs. The following example provided in the MIA's own consumer guidance is illustrative:

For example: your sofa was destroyed by a covered cause of loss, such as fire. The sofa was purchased 10 years ago for \$1,500 and would be fully depreciated in 20 years. Since the sofa is 10 years old, it has depreciated 50%, or \$750.

Maryland Insurance Administration, "A Consumer Guide to Homeowners Insurance," at p. 28 (<https://insurance.maryland.gov/Consumer/Documents/publications/homeownersinsguide.pdf>).

The MIA's example above does not only apply depreciation to the sofa's material costs. Rather, depreciation is applied to the sofa's full value as a finished product, which includes both the materials and embedded labor that went into making it. Applying depreciation to the full value of damaged property results in a logical, common-sense valuation of the insured's actual economic

loss. Indeed, a reasonable person would expect that a sofa that is 50% through its useful life at the time of the loss would be worth approximately 50% of its original purchase price.

The application of depreciation to building damage is no different. To illustrate, consider the following example:

A roof is damaged by a hailstorm and needs to be replaced. The new roof will cost \$10,000 -- \$4,000 for materials and \$6,000 for labor. If the roof was 24 years old and expected to last 30 years, what would the roof's estimated value be immediately before the storm (i.e., the ACV)?

Given the roof has only 20% of its useful life remaining, a logical estimate of the roof's value at the time of the storm would be approximately \$2,000 ($\$10,000 \times .20$). In contrast, if depreciation were applied only to the roof materials and not to the embedded labor costs, the ACV payout would be \$6,800 [$(\$4,000 \times .20) + \$6,000$]. This is three times more than the roof was actually worth before the storm.

As illustrated by these examples, applying depreciation to the full RCV of the damaged property fairly and equitably compensates the insured for the value of the damaged property at the time the loss occurred. In doing so, the insured is restored to the approximate financial position they were in prior to a covered loss.

RCV policies allow an insured to also recover the full RCV (i.e., the difference between the RCV estimate and the amount of the initial ACV payment) if, and when, the repairs are completed. When the insured incurs the cost to complete such repairs, the RCV coverage applies to return the insured to the approximate financial position they were in before incurring the costs to repair the property. Conversely, as explained above, applying depreciation only to materials when calculating the ACV of damaged property allows insureds to recover more than the actual economic value of what they lost and, if the repairs are not completed, the insured is placed in a better position than before the loss.

Depreciating Labor is Consistent with the Principle of Indemnity and Reduces Blight

Depreciating labor is also consistent with the principle of indemnity underlying ACV coverage and reduces blight. It is the property's overall "value" that depreciates. For example, once a roof has been constructed, it ages, or incurs wear and tear. The labor that went into its construction or prior repairs is indivisible from the whole. Applying depreciation to the full RCV (materials and the embedded labor) to calculate the ACV of the property fully indemnifies the insured for the economic value of what they lost.

While an insured always has the option under RCV policies to recover the full RCV of damaged property by completing the repairs, RCV policies do not require that an insured repair damaged property. In fact, many insureds opt not to make repairs. One national carrier reported that between 2019 and 2023, more than 30% of homeowners that submitted claims for property damage in Maryland never made a claim for recoverable depreciation.

Additionally, the interconnectedness of depreciation until repair or replacement is made serves to encourage timely repair to the property by the insured, thereby protecting the mortgage holder's interest in the property and the insurer from additional risk of loss while the property is unrepaired.

Under the proposed Bulletin, homeowners that decide not to repair the damaged property would receive payment for labor costs that they never will incur. This outcome is inconsistent with the principle of indemnity upon which insurance is based. It also highlights why most RCV policies are written to only provide ACV coverage until an insured completes the repairs.

A decent respect for the principles of equity in contracting shows that including 100% of the labor costs as part of an ACV payment to an insured results in unjust enrichment if: (1) the insured does not make repairs; and/or (2) the insured does make repairs, but the cost of labor actually incurred is less than the estimate of labor paid as part of the ACV payment. Such unjust outcomes are detrimental to the consumer base at large as they may increase insurance product pricing over the long run.

By withholding depreciation until after the insured contracts to have repairs completed, the policy also encourages insureds to timely repair property damage. Completing the repairs in a timely manner helps to protect the property from further damage that could be caused by leaving damaged property unrepaired, such as water damage that may result when a roof is not timely repaired. Timely repairs also reduce blight and stabilize the property values of both the damaged structure and other properties in the neighborhood.

Depreciating Labor Does Not Cause A Significant Financial Burden On Consumers

The MIA appears concerned that depreciating labor unfairly puts a significant financial responsibility on insureds to pay labor costs. However, in addition to the fact that RCV policies do not typically cover future labor costs before the work is completed and the costs are incurred, indemnifying an insured for the economic value of what is lost (i.e., the ACV) does not typically impose any unusual additional financial burden on consumers to make repairs.

First, a policyholder is **not** prohibited from recovering the full cost to replace damaged property. Under most policies, a policyholder may recover on an RCV basis, and thereby receive an economic gain, simply by making the repairs.

Second, policyholders are generally **not** required to pay for the full cost of repairs out of their own pocket before receiving the RCV payment. The ACV amount is typically sufficient to provide a deposit for a contractor to commence work if the insured intends to make repairs. Contractors do not typically insist on full payment before completion of work. In fact, it would be unwise for a homeowner to pay the full cost of repair upfront.

Lastly, claim professionals generally meet with contractors if there is a concern about whether an insurer's estimated replacement cost value is sufficient to cover the cost of the repairs, and contractors know that the insurer will promptly pay the amount held back for depreciation when repairs are completed. Further, on larger losses, progress payments are also frequently paid to the insured as the work is completed.

In short, applying depreciation to materials does not cause any unusual financial burden on a consumer that wants to repair damaged property.

Any Change in the MIA's Treatment of Labor Depreciation Should be Done Prospectively, Transparently, and Through Proper Rulemaking

The proposed Bulletin states that it is "the Administration's position that, pursuant to § 27-304(6), depreciation of labor costs, when committed with such frequency as to indicate a general business

practice, constitutes an unfair claim settlement practice in violation of Subtitle 27.” APCIA’s members respectfully disagree.

For the reasons discussed above, applying depreciation to the full RCV is a fair, equitable, and accurate method for estimating the economic value of property at the time of the loss (i.e., the ACV). If the MIA seeks to change the treatment of labor depreciation, it should occur prospectively, transparently, and through proper ruling making.

The MIA’s proposed prohibition of policies that allow for the depreciation of labor has not been required or endorsed by any court. While some courts in other jurisdictions have held that depreciation should only be applied to the cost of materials when estimating ACV, these decisions were based on perceived ambiguities in the policies at issue. To our knowledge, no court has prohibited the use of policy language that expressly indicates the ACV of damaged property will be calculated by depreciating the material and non-material components of the RCV. To the contrary, such policy provisions have been approved in many jurisdictions, including Maryland, and are widely used by insurers.

In fact, courts have acknowledged that a policy may be endorsed to eliminate any potential ambiguity on the issue. As one court noted, “[a]s both parties agree, State Farm has always been free to explicitly state in its Mississippi homeowners policies that Actual Cash Value includes labor depreciation.” *Mitchell v. State Farm Fire & Cas. Co.*, 954 F.3d 700, 705 n.4 (5th Cir. 2020); see also *Hicks v. State Farm Fire & Cas. Co.*, 751 F. App’x 703, 709 (6th Cir. 2018) (“[F]ollowing this decision, State Farm can ensure that the wording of any new homeowner’s insurance policy it offers in Kentucky defines ACV depreciation to include both labor and materials.”); *Franklin v. Lexington Ins. Co.*, 652 S.W.3d 286, 302 (Mo. Ct. App. 2022) (“If Lexington wished to depreciate labor, it had the ability to include such a provision in its policy, but it did not do so.”).

Similarly, we are not aware of any court that has found that applying depreciation to the full replacement cost of damaged property is an unfair trade practice. The MIA would be the first to reach such a conclusion and would be doing so without any prior notice to the industry. In fact, the MIA’s prior approval of policy language that expressly provides for the depreciation of labor and materials when calculating the ACV of property gives the impression that the MIA has not previously viewed the practice as constituting an unfair business practice.

Retroactively prohibiting labor depreciation and including the unfair claim settlement practice language in the proposed Bulletin could impair existing policies, disrupt settled claims, and result in potential class action litigation related to the handling of prior claims. This is unfair to the industry and unwarranted. It may also exceed the MIA’s regulatory authority and raise constitutional issues under both the Contract Clause and Due Process Clause.

Conclusion

For the reasons discussed above, we respectfully request that the MIA withdraw the proposed Bulletin and reconsider its position concerning the depreciation of labor. Rather than a blanket prohibition, we urge the MIA to:

- (1) continue to recognize the validity of policy language that depreciates the full RCV (i.e., embedded material and non-material components) as a fair and equitable method for calculating the ACV of damaged property; and
- (2) apply any rule changes prospectively, transparently and through proper rulemaking.

We welcome the opportunity to work collaboratively with the MIA to develop standards that fairly protect consumers and the integrity of the insurance marketplace.

Questions Posed by our Members

In addition to our comments, our members have submitted questions relevant to the feedback solicited in response to the proposed Bulletin being circulated:

- If a company has a filed and approved ACV loss settlement form which also uses a payment schedule (both of which are ISO based), would such a payment schedule for which material and other installation costs such as overhead, profit, labor, taxes and fees be considered subject to the bulletin?
- Is depreciation solely focused on labor or would other things such as overhead/profit or sales tax also be subject to the bulletin?
- The bulletin referenced property insurers. Our interpretation is that this bulletin is intended to apply to residential property insurance policies only. We would appreciate the department confirming that the interpretation is correct.

Thank you for the opportunity to share our concerns regarding the proposed Bulletin. APCIA wishes to work collaboratively with the MIA on this issue. Please do not hesitate to contact us if you have questions, need additional information, or would like to meet to discuss further.

Sincerely,



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