



July 15, 2021

State of Washington Office of the Insurance Commissioner
302 Sid Snyder Ave., SW
Olympia, WA 98504
Attention: David Forte

Sent via email to: rulescoordinator@oic.wa.gov.

RE: Draft Proposed Regulation Prohibiting the Depreciation of Labor on Property Claims (R 2021-04) – Trades Written Comments in Regard to First Stakeholders’ Draft

Dear Commissioner Kreidler:

On behalf of the National Association of Mutual Insurance Companies (NAMIC), the American Property Casualty Insurance Association (APCIA), and the NW Insurance Council (NWIC), we would like to share our concerns with you about the above captioned proposed regulation and the recently-distributed stakeholder draft.

Generally speaking, we are concerned that the draft proposed regulation would adversely impact consumers who want the opportunity to purchase an Actual Cash Value (ACV) coverage policy that is discounted in price to reflect the rational depreciation of the value of the insurance claim for labor costs. The trades are also concerned that the proposed regulation is inconsistent with the long-established principles governing how depreciation of property is calculated and is an inappropriate regulatory overreach into the contractual relationship between insurers and their policyholders.

The trades respectfully submit the following comments for consideration:

1) The draft proposed regulation exceeds the regulatory authority of the Office of the Insurance Commissioner (OIC)

The trades are concerned that the proposed regulation would effectuate a fundamental change in current state law on the contractual rights and responsibilities of insurers and consumers as agreed to by the parties in the insuring agreement. Any proposed change to statutory law should be accomplished via the legislative process, not by way of regulatory overreach into the legislative function. Furthermore, any disagreement over the legality of a provision in an insuring agreement should be left to the authority of the judicial branch of government.

The proposed draft regulation fails to cite any specific regulatory authority for the OIC to deny insurance consumers their right to purchase an Actual Cash Value (ACV) insuring agreement priced to reflect “depreciation of labor or betterment”.

The OIC has also failed to cite any enabling legislation that authorizes the department to define what depreciation of property means and how it shall be applied to the insurance policy. Further, there is no statute or case law on point to support the OIC’s position that depreciation may not legally include “the expense of labor necessary to repair, rebuild or replace covered property...” The OIC lacks authority to rewrite well-established contract law and impose its own interpretation on insurers and policyholders, in this case to the detriment of the marketplace and certain insurance premium-cost sensitive consumers.

The trades believe that a) the OIC lacks the regulatory authority to interfere with the contractual rights of insurers and policyholders; b) there is no current problem in the insurance marketplace that the proposed regulation is necessary to remedy; and c) the proposed regulation is not in the best interest of insurance consumers.

2) The draft proposed regulation is contrary to the generally accepted understanding of how ACV is calculated.

The notion of calculating ACV as replacement cost less partial depreciation (i.e., only of the cost of materials) is not a recognized method of valuing property for any purpose. It would be contrary to the manner in which the vast majority of courts have interpreted ACV and determined the amount to deduct for depreciation of property for more than a century. It is the economic value of the structure, not merely the value of the materials, that depreciates over time. The economic value of property cannot be accurately measured by determining its replacement cost and then subtracting a portion of the actual depreciation in the property’s value.

The approach contemplated by the draft proposed regulation has been squarely rejected by a strong majority of state supreme courts that have addressed the issue, including the supreme courts of Oklahoma, Nebraska, Minnesota and North Carolina. As the North Carolina Supreme Court explained in its February 2020 decision in *Thomas Accardi v. Hartford Underwriters Insurance Company*, “[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.”

The draft proposed regulation would not only disrupt well-settled law and longstanding insurance industry practice; it would mean that the value of property for insurance purposes would be determined far differently from how it is determined for the very same property for property tax assessments, eminent domain, real estate appraisals, and other valuations of real property. In those contexts, labor costs are not segregated from material costs for purposes of calculating depreciation and determining actual economic value. Rather, depreciation is applied to the total estimated replacement cost. Requiring otherwise would undermine the certainty in the construction of 100-plus year old insurance policy language that effectively provides for consumer choice in the insurance marketplace.

In at least one state in which the law on labor depreciation was changed in the manner contemplated by the draft proposed regulation, it impacted how much policyholders pay for homeowners’ insurance. In 2013, the Arkansas Supreme Court (in *Adams v. Cameron Mutual*

Insurance Company) found the term ACV to be ambiguous, notwithstanding its longstanding plain meaning, and then enforced an insurance department rule prohibiting depreciation of labor costs. Following this decision, according to data from the National Association of Insurance Commissioners (NAIC), homeowners' insurance premiums in Arkansas increased by 5.4% in 2014, and by another 4.7% in 2015. (See National Association of Insurance Commissioners, Dwelling Fire, Homeowners Owner-Occupied, and Homeowners Tenant and Condominium/Cooperative Unit Owners Insurance: Data for 2013-2016, Table 4). In 2017, the Arkansas legislature stepped in to correct this distortion of the marketplace, repudiating Adams by enacting a statute permitting depreciation of the full replacement cost value, including the labor component.

3) The draft proposed regulation could adversely impact affordability of insurance, and discourage consumers from repairing damaged property, i.e. being good personal risk managers.

In addition to fundamentally altering the contractual rights and responsibilities of insurers and policyholders, the draft proposed regulation will also force insurers to recalculate the cost of ACV insurance products to make sure that their rates are actuarially sound in light of the new coverage requirements that would be imposed. Additionally, the draft proposed regulation will create new and unnecessary administrative costs for insurers, which must also be included in rate calculations.

Current insurance rates are partially based upon the fact that depreciation may be applied to the covered property and related labor costs associated with the insurance claim. It is hard to imagine how this regulatory mandate would not increase the cost of insurance coverage for consumers. The draft proposed regulation would also create claims adjusting problems for insurers who use computer estimating software that calculates labor costs and property material costs together.

Additionally, the trades are concerned that the draft proposed regulation will discourage consumers from being good personal risk managers who fully repair their damaged property. The principles underlying depreciation in its proper sense provide consumers with an economic incentive to *actually* repair the damaged property, so as to minimize the consumer's risk of loss exposure and prevent future property damage that may be excluded from insurance coverage. The draft proposed regulation is more likely to harm consumers rather than help them, because it will allow for the diversion of funds that should be used to repair the damaged property.

We noted with interest the Commissioner's blog post regarding the proposed rulemaking, which included this inaccurate – but telling – statement:

“If your policy allows the insurer to depreciate labor costs and you have a claim, the contractor you work with may require you to pay labor costs up front. Otherwise, the contractor is forced to float the cost of paying its employees until all repairs are complete. That can mean a large output of cash for policyholders that they won't get back until months later.”

Insurers routinely – often with the support of insurance regulators as well as agencies that regulate the residential construction industry – seek to prevent fraud by recommending that no consumer should pay any repair costs “up front,” prior to the satisfactory conclusion of any repair project, and they encourage claimants to work with their insurance agent or contractor to make sure repairs are completed as promised, in a quality fashion, prior to paying in full for any repairs.

Reputable contractors never demand full payment upfront. But they do need some funds to start securing permits and purchasing materials, which is what the ACV payment provides. Once the repairs are completed, a final invoice is issued. When the insured is satisfied, the difference between the ACV payments, including any additional advances and the final cost of the repairs, is made up to the policy's limits.

Accordingly, we find the scenario set forth in the blog post - that an insured might be "out of pocket" for a lengthy time period because they were forced by a contractor to "pay up front for labor costs" - to be speculative and highly unlikely at best, and we would encourage the OIC to support insurer efforts to fight contractor fraud as an alternative to exceeding its statutory authority in order to interfere in insurance contracts in a way that is likely to significantly impair the market for ACV-based property policies for Washington consumers.

In closing, the trades respectfully request that the OIC withdraw the draft proposed regulation and work with insurers, on a case-by-case basis, to address any specific concerns the department has with current claims adjusting practices as they relate to depreciation of property. A blanket prohibition against the depreciation of labor will create unnecessary financial burdens for insurance consumers without providing them with any appreciable benefit.

Thank you for your consideration.

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