

Illinois Supreme Court Rules That Insurer May Not Depreciate Labor Costs In Calculating Actual Cash Value

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As discussed in previous Alerts, several state supreme courts and federal appellate courts have addressed whether an insurer may depreciate labor costs in calculating actual cash value (“ACV”). See [May 2021 Alert](#); [March](#) and [April 2020 Alerts](#); [April 2019 Alert](#); [March 2017 Alert](#); [January](#) and [February 2016 Alerts](#). Outcomes have turned largely on policy language, as well as governing jurisdictional law and public policy considerations. Last month, the Illinois Supreme Court weighed in, ruling that labor costs may not be depreciated in the ACV calculation. *Sproull v. State Farm Fire & Cas. Co.*, 2021 IL 126446 (Ill. Sept. 23, 2021).

The State Farm policy provided that “we will pay only the actual cash value at the time of the loss of the damaged part of the property, up to the applicable limit of liability.” The policy did not define ACV. When State Farm depreciated both labor and materials in calculating ACV payment, the policyholder filed a putative class action, alleging breach of contract and deceptive business practices.

An Illinois trial court denied State Farm’s motion to dismiss. Noting the lack of Illinois case law and jurisdictional split on this issue, the court concluded that ACV was ambiguous and should be construed in the policyholder’s favor. The trial court rejected State Farm’s argument that Illinois statutory law, which states that the method for calculating ACV is “replacement cost of property at time of loss less depreciation, if any,” permits depreciation of both labor and materials. 50 Ill. Adm. Code 919.80 (d)(8)(A) (2002). The trial court certified the following question to the appellate court:

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?

The appellate court answered the question in the negative. Deeming the policy unambiguous, the court held that the phrase “replacement cost of property” refers to “real property—an asset that can lose value over time due to wear and deterioration, resulting from use or the elements, and does not refer to services, such as labor.” The Illinois Supreme Court affirmed, though on different grounds.

The Illinois Supreme Court found that the policy was ambiguous because its language was susceptible to two reasonable interpretations. The

court rejected State Farm’s contention that even if the policy was ambiguous, it may not be construed against State Farm because Illinois statutory law supplies the definition of ACV. The court explained that while the statute generally prescribes the method of calculating ACV as “replacement cost of property at time of loss less depreciation, if any,” it does not define depreciation or identify a specific method for its calculation. Having found the policy ambiguous, the court construed it in the insured’s favor. Notably, the court expressly limited its ruling to cases in which the policy does not define ACV to expressly include labor depreciation.

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