

## ARIZONA SUPREME COURT TAKES UP CASE INVOLVING DEPRECIATION OF LABOR AND MATERIALS UNDER INSURANCE POLICIES

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*Walker v. Auto Owners*

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The Arizona Supreme Court recently accepted two certified issues from the Ninth Circuit Court of Appeals that will have a significant impact on how property claims are handled under insurance policies in Arizona. In the case, *Walker v. Auto Owners*, the Arizona Supreme Court will address two issues:

- When a homeowner's insurance policy does not define the terms "actual cash value" or "depreciation," can an insurer depreciate both the costs of materials and labor in determining the "actual cash value" of a covered loss?
- Is the broad evidence rule applicable in Arizona such that an insurer and/or fact finder may consider labor depreciation as a pertinent factor in determining actual cash value?

The issue of whether labor may be depreciated as part of an actual cash value determination is undecided in Arizona. On one end of the spectrum, federal courts have determined that labor is subject to depreciation.<sup>[1]</sup> On the other end of the spectrum, other federal courts have held that an insurer cannot depreciate the cost of labor.<sup>[2]</sup>

This issue of whether labor may be depreciated, even in the context of mixed costs (i.e., costs representing both labor and materials) is a trending topic among courts. For example, in 2017, the District Court for the Middle District of Tennessee went through the split between states and federal courts regarding this issue.<sup>[3]</sup> Federal courts have been certifying the question to the state Supreme Court in which it sits.

The state supreme courts are split on the issue. The Supreme Court of Tennessee in *Lammert* accepted the certifying question and held that because the insurance policy was ambiguous, it was to be construed against the insurance company. In so doing, the Supreme Court of Tennessee held that "depreciation" did not include depreciation of labor costs, even when they were mixed.<sup>[4]</sup> Conversely, states and district courts have held that depreciation of labor expenses in mixed costs was permissible.<sup>[5]</sup>

No Arizona court has decided whether labor may be depreciated, however, in *Melancon v. USAA Cas. Ins. Co.*<sup>[6]</sup>, the Arizona Court of Appeals held that an insurer was not authorized to reduce coverage for depreciation where the policy did not explicitly state so. Melancon involved USAA depreciating certain parts used to repair Melancon's vehicle. According to the court, the USAA policy "[i]n defining its limit of liability...stated... (1) actual cash value of the stolen or damaged property; or (2) amount necessary to repair or replace the property." USAA argued that actual cash implies a reduction for depreciation. The Court, however, refused to read into the policy language concerning depreciation, even though the Arizona Department of Insurance defines actual cash value accounting for "less an amount for depreciation."

The parties in *Walker v. Auto Owners*, as well as other interested parties, are still submitting briefs to the Arizona Supreme Court, which has granted, but not set a date, for oral argument. A decision is expected later in 2022.

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<sup>[1]</sup> *Cranfield v. State Farm Fire & Cas. Co.* No. 1:16-cv-1273, 2018 WL 6162900 (N.D. Ohio, Nov. 26, 2018); *Perry v. Allstate Indem. Co.*, No. 1:16-cv-01522, 2018 WL 6169311 (N.D. Ohio, Nov. 26, 2018); *Branch v. Farmers Ins. Co., Inc.*, 55 P.3d 1023, 1027, ¶ 13 (Okla. 2002).

[2] *Titan Exterior, Inc. v. Certain Underwriters at Lloyd, London*, 297 F.Supp.3d 628 (D. Miss. 2018); *Adams v. Cameron Mut. Ins. Co.*, 430 S.W.3d 675, 676 (Ark. 2013) *Hicks v. State Farm Fire & Cas. Co.*, No. 18-5104, 2018 WL 4961391 (6th Cir. Oct. 15, 2018).

[3] *Lammert v. Auto-Owners Ins. Co.*, 286 F.Supp.3d 919 (M.D. Tenn. 2017)

[4] *Graves v. Am. Fam. Mut. Ins. Co.*, 686 Fed.Appx. 536 (10th Cir. 2017) (applying Kansas law)

[5] *Ware v. Metro. Prop. & Cas. Ins. Co.*, 220 F.Supp.3d 1288 (M.D. Ala. 2016); *Papurello v. State Farm Fire & CAs. Co.*, 144 F.Supp.3d 746 (W.D. Pa. 2015).

[6] *Ware v. Metro. Prop. & Cas. Ins. Co.*, 220 F.Supp.3d 1288 (M.D. Ala. 2016); *Papurello v. State Farm Fire & CAs. Co.*, 144 F.Supp.3d 746 (W.D. Pa. 2015).

**Patrick Gorman** concentrates his practice in the areas of bad faith and extra-contractual liability, insurance coverage, professional liability and other general civil litigation matters. In his practice, he represents large insurers in bad faith and breach of contract claims, often with allegations of punitive damages, through all phases of litigation in state and federal court.

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