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6th Circuit Approves Class Action for Ky. Underpayments by State Farm

A federal appellate court has cleared the way for a class-action lawsuit to proceed against State Farm Fire and Casualty Insurance Co. that may force the insurer to correct underpayments paid to some 65,000 policyholders.

A 6th Circuit Court of Appeals panel affirmed a district court ruling that certified a class of plaintiff's who may proceed with breach-of contract claims against State Farm. A key issue in the case has already been decided in 2018, when the 6th Circuit affirmed a trial court ruling that insurers cannot include labor costs when calculating depreciation to determine a property's actual cash value (ACV) under Kentucky law.

"The improper handling of ACV obligations has been a problem for insureds across the country and has been an obstacle for people who have suffered catastrophic losses, and this is a positive step in the right direction," said Amy Bach, executive director of United Policyholders.

Susan Hicks, one of two lead plaintiffs in the case, is a widow who's husband died when the couple's home in Owingsville, Kentucky burned down in 2014. State Farm deducted more than \$60,000 for depreciation when it determined the actual cash value of the home. The Xactimate calculator that it used included depreciation for both materials and labor.

State Farm deducted more than \$40,000 for depreciation of lead plaintiff Don Williams' house in Monticello, Kentucky after it was damaged by fire. Williams chose not to repair the home and hasn't recovered the depreciated labor costs that were withheld from payment, the suit alleges.

The appellate court decision continues a long losing battle for State Farm. The U.S. District Court for Eastern Kentucky ruled in 2015 that under Kentucky law, insurers cannot include depreciation of labor costs when calculating actual cash value. The 6th Circuit affirmed that ruling in 2018.

State Farm changed its method of depreciation about three months after the district court ruled it was improper to deduct for labor costs. The plaintiff's attorneys say that the insurer needed only to "unlick" one of the

boxes used by the Xactimate software to come up with the correct actual cash value.

The plaintiffs filed suit in 2017 seeking to certify as a class of plaintiffs 65,575 policyholders who received payouts where labor costs were improperly calculated from Feb. 28, 2004 to July 25, 2015.

Wystan M. Ackerman, with the Robinson & Cole law firm in Hartford, Connecticut, filed an amicus brief supporting State Farm's position on behalf of the American Property and Casualty Insurance Association. He said state laws are not consistent on the issue of whether labor cost depreciation can be used when calculating actual cash value.

While the 6th Circuit has ruled that insurers cannot include labor costs when deducting for depreciation in some instances, such deductions may still be proper in states where statutes allow insurers to present broad evidence to support their valuations. Ackerman said the 8th Circuit has ruled that insurers can deduct for depreciation of labor costs under Missouri law. A federal district court reached a similar conclusion in Ohio.

In any case, Ackerman said that most Kentucky property insurers have stopped including depreciation of labor costs in their actual cash value calculations. Some jurisdictions, such as California, strictly forbid the practice, he said.

The 6th Circuit ruling moves the case back to trial court, which must calculate the damages owed. The amount may far surpass the amount that was underpaid because of the Xactimate calculations. The plaintiff's are also seeking pre-judgment interest on the amount that was underpaid, which in Kentucky is 6 percent a year.

The scope of the class of defendants may also change as the case moves forward. Circuit Justice David W. McKeague dissented to a part of the ruling. He said the district court judge certified an overly broad class of plaintiffs that includes claims by homeowners who repaired their homes and were paid those full costs.

McKeague said State Farm did not breach the terms of its policies those cases.

“(In other words, State Farm was contractually obligated to be a good neighbor, not a great one,)” McTeague wrote in dissent. He said he expects the trial court to address that question before a final order is issued.

State Farm issued this statement: “State Farm respectfully disagrees with the appellate court's decision affirming class certification in this case. We deny the allegations and are confident we have upheld our commitment to our policyholders.”

About the photo: A cellar is all that remains of this home in Morning View, Ky, which was in the direct path of the tornado in March 2012. File photo by Marilee Caliendo/FEMA

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