

# COMMISSIONER OF SECURITIES & INSURANCE

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COMMISSIONER



OFFICE OF THE  
MONTANA STATE AUDITOR

## ADVISORY MEMORANDUM

TO: All Property Insurers and Licensed Adjusters

FROM: Matthew M. Rosendale, Sr.  
Montana State Auditor  
Commissioner of Securities and Insurance

DATE: December 23, 2019

SUBJECT: Depreciation of Labor

It has come to the attention of the Office of the Montana State Auditor, Commissioner of Securities and Insurance (CSI), that some property insurers desire to depreciate labor in addition to physical materials when indemnifying Montana insureds for damaged property. Additionally, other insurers have requested the CSI for clarification on this issue.

For the following reasons, it is the position of the CSI that labor may not be depreciated in Montana. The Montana Insurance Code provides:

- If there is no valuation in the policy and unless a basis more favorable to the insured is provided for in the policy, the measure of indemnity in an insurance against fire is the expense, at the time that the loss is payable, of replacing the thing lost or injured, in the condition in which it was at the time of the injury . . .

Mont. Code Ann. § 33-24-101.

Although the preceding provision specifically refers to fire as the cause of the loss, this general principle is the same for all causes of property damage or loss. Since 1928, the Montana Supreme Court has held that “[i]ndemnity is the basis or foundation of all insurance law.” *Lee v. Providence Wash. Ins. Co.*, 82 Mont. 264, 276, 266 P. 640, 644 (1928). This requires the insurer to “put [the insured] in as good a condition, so far as practicable, as [s]he would have been if no [loss] had occurred.” *Id.*

Under this premise, it makes sense that, in an actual cash value policy, the value of materials may be depreciated if the contract allows for it. This is because the insured’s property at the time of the loss necessarily consists of aged materials. Depreciation may be applied to physical materials in certain circumstances where the materials have deteriorated due to age, wear, and tear in order to determine the “actual cash value” of property prior to the loss. *Id.*, 82 Mont. 264, 266 P. 640.

Montana case law defines actual cash value as the “actual value expressed in terms of money of the thing for the purpose for which it was used.” *McIntosh v. Hartford Fire Ins. Co.*, 106 Mont. 434, 442, 78 P.2d 82, 84 (quoting *Fedas v. Ins. Co.*, 151 A. 285, 288 (Pa. 1930)). The “result is to enable the parties to restore the property to as near the condition as it was at the time of the [loss], or to pay for it in cash; that was the loss insured against.” *Id.*

In order to put the insured in as good a condition as she would have been had no loss occurred, the insured must have property repairs. This requires labor, which makes it a necessary part of the indemnification the contract provides. Unlike ageing materials, the value of labor does not reduce due to the passage of time. In order to properly indemnify an insured the insured must be paid the current labor rate.

**Labor of any kind related to the repair, rebuilding, or replacement of covered property must not be depreciated. In case of a partial loss, a deduction for physical depreciation shall apply only to components of the insured property that are normally subject to repair and replacement during the useful life of the property. The insurer must pay the cost for physical materials less any depreciation, plus the cost of labor necessary to repair or replace insured property.**

This position is not unique to Montana. States throughout the country agree that the labor does not depreciate. The average reasonable consumer would not understand depreciation of their property to mean that they are covered for only a small fraction of the labor required to replace it in the event of a loss.

**ALL CLAIMS HANDLING AND ALL INSURANCE FORMS MUST CONFORM TO MONTANA LAW AS SET FORTH HEREINABOVE.**

Policy forms that attempt to apply depreciation to labor will not be approved. Insurers who have policy forms currently in use that attempt to apply depreciation to labor must revise those policy forms, through an endorsement or otherwise, and resubmit them to the CSI for approval no later than March 31, 2020. Once the forms have been approved the correct version must be mailed to all policyholders and certificate holders within 60 days following approval.

If you have questions regarding claims handling or form filing, please contact the CSI Policyholder Services Bureau or the CSI Forms Bureau.

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