

# Actual Cash Value, Direct Physical Loss Coverage Update

May 17, 2021

## Actual Cash Value – South Carolina

### *Butler v. Travelers Home & Marine Ins. Co.*

--- S.E.2d ---, 2021 WL 1900088 (S.C. May 12, 2021)

The Supreme Court of South Carolina accepted a certified question from an action filed in a South Carolina federal court, which arose from two homes that were damaged in separate fires. Both homes were insured under policies issued by Travelers Home & Marine Insurance Company (Travelers), and both homeowners elected to receive a payment for the Actual Cash Value (ACV) of the damaged property.

The certified question that the Supreme Court was asked to answer was: “[w]hen a homeowner’s insurance policy does not define the term ‘actual cash value,’ may an insurer depreciate the cost of labor in determining the ‘actual cash value’ of a covered loss when the estimated cost to repair or replace the damaged property includes both materials and embedded labor components?” In analyzing this question, the Supreme Court noted that Travelers determined the ACV by reducing the depreciation amount for materials and labor from the replacement cost value. According to the Supreme Court, including depreciation for embedded labor costs – that is, costs that are “no longer separable from the cost of materials” – is reasonable. The Supreme Court illustrated the concept of embedded labor costs by explaining that shingles and nails have labor costs when they are first manufactured; however, when they are sold to a roofer, the labor costs become embedded in the market price.

The Supreme Court further explained that when labor costs are embedded in a material, it is “impractical, if not impossible, to include depreciation for materials and not for labor to determine ACV of the damaged property.” Instead, the replacement cost value of the damaged property “is reasonably calculated as a unit.” “Therefore, we answer the certified question ‘yes,’ because it makes no sense for an insurer to include depreciation for materials and not for embedded labor.”

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## Direct Physical Loss – Northern District of Alabama (Alabama Law)

### *Serendipitous, LLC v. Cincinnati Ins. Co.*

No. 2:20-cv-00873, 2021 WL 1816960 (N.D. Ala. May 6, 2021)

The U.S. District Court for the Northern District of Alabama denied a motion to dismiss brought by Cincinnati Insurance Company (Cincinnati), ruling that Cincinnati could potentially owe coverage for business income losses sustained by a group of restaurants' claims for pandemic-related losses.

Under the civil authority orders issued by the World Health Organization, state of Alabama, Jefferson County and the City of Birmingham, restaurants in Birmingham, Alabama could only provide curbside pick-up for several months and were later only allowed to seat customers at a restricted capacity, resulting in business income losses. Several restaurants owned by Serendipitous, LLC (Serendipitous) sought to recover those losses from Cincinnati, which issued an "all risk" policy to Serendipitous. Serendipitous claimed that its policy included coverage for loss of use of property due to the COVID-19 pandemic, as well as business interruption and civil authority coverages. Cincinnati denied coverage on the basis that the business disruption was not caused by direct physical loss. Subsequently, Serendipitous filed suit against Cincinnati.

Cincinnati moved to dismiss Serendipitous' complaint. The district court denied the motion to dismiss, reasoning that Serendipitous has "alleged facts that, if proven, constitute actual physical loss of their buildings and furniture during the pandemic." The district court then identified examples of such losses, including closing the restaurants to disinfect them as a result of employees who tested positive for the virus and civil authority orders that restricted access to the properties. The district court further reasoned that "[t]he policy language indicates that the insurer understands that an insured may suffer physical loss without physical alteration of property because the policy excludes from coverage some expenses incurred because of invisible substances like vapor and fumes. Cincinnati could have excluded invisible substances like viruses but did not."

The district court distinguished this case from prior cases that held that there was no potential for coverage on the basis that, here, the restaurants actually had to be closed and disinfected as a result of employees who tested positive for COVID-19. As result, the district court refused to dismiss Serendipitous' complaint and allowed the action to proceed.

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