97326-1

NO. 78107-3-I

DIVISION I
COURT OF APPEALS
OF THE STATE OF WASHINGTON

---

MOUNT ZION LUTHERAN CHURCH,

Appellant,

v.

CHURCH MUTUAL INSURANCE COMPANY, a foreign corporation,

Respondent.

---

# PETITION FOR REVIEW

Mills Meyers Swartling P.S.
Bruce A. Winchell, WSBA # 14582
Kasey D. Huebner, WSBA # 32890
Gretchen Graham Salazar, WSBA # 26186
1000 Second Avenue, 30th Floor
Seattle, WA 98104
(206) 382-1000
Attorneys for Appellant

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

### Cases



### Other Authorities



### Rules



### Treatises

## I. IDENTITY OF PETITIONER

The Petitioner is Mount Zion Lutheran Church ("Mount Zion"). Mount Zion is the Plaintiff in the underlying action and Appellant at the Court of Appeals.

## II. CITATION TO COURT OF APPEALS DECISION

Mount Zion seeks review of the Court of Appeals decision captioned *Mount Zion Lutheran Church v. Church Mutual Insurance Company*, No. 78107-3-1 (Div. I), which was filed on March 18, 2019. Pursuant to a motion by Church Mutual Insurance Company ("Church Mutual"), which was opposed by Mount Zion, the Court of Appeals issued an order to publish the decision on May 14, 2019. The citation to the published opinion is not yet available.

## III. ISSUE PRESENTED FOR REVIEW

The issue presented for review pertains to interpretation of the Replacement Cost provision of the applicable insurance policy, which states that the insurer need not pay on a Replacement Cost basis for any loss or damage "[u]ntil the lost or damaged property is actually repaired or replaced," and limits Replacement Cost proceeds to the least of (a) the policy limit, (b) the estimated cost to repair or replace the lost or damaged property on the same premises (often called the "hypothetical cost to repair

or replace"); or (c) the amount the insured actually spends that is necessary to repair or replace the lost or damaged property.

Specifically, when an insured rebuilds a functionally similar (but not identical) structure following a fire, the issue is whether the foregoing provisions allow the insured to recover under subparagraph (c) its actual rebuilding expenditures up to the lesser of (a) (the policy limit) or (b) (the hypothetical cost to repair or replace), or whether the insured's actual rebuilding expenditures are recoverable under (c) only to the extent that each individual expenditure identically matches a line item on the insurer's repair cost estimate.

Petitioner Mount Zion contends that under the Supreme Court's clear and unequivocal decision in *Hess v. North Pacific Ins. Co.*, 122 Wn.2d 180, 89 P.2d 586 (1993), an insured is permitted to rebuild a different structure and, under (c), recover the amount actually spent, up to the lesser of (a) or (b).

The Court of Appeals disagreed with Mount Zion and held that an insurer has no obligation "to pay for [an insured's] remodeling choices" and has a "contractual right" to evaluate every line item of an insured's claim to determine whether each expenditure was "necessary" to repair or replace a corresponding item of lost or damaged property. *Mount Zion Lutheran*

*Church v. Church Mutual Ins. Co.*, No. 78107-3-I (Div. I, Mar. 18, 2019), at 11.

The effect of the Court of Appeals' decision will be to dramatically change the way in which insureds go about rebuilding after a fire. Previously, under *Hess*, an insured had access to a pool of funds (the lesser of the policy limit or the hypothetical cost to repair or replace the lost or damaged property), which the insured could then use to rebuild a different structure on the same or a different site, or purchase a replacement structure. In rebuilding, the insured was free to make compromises in one area in order to make upgrades in another area. Now, insureds will be forced to identically replicate the materials and designs that were destroyed by fire or risk losing their Replacement Cost insurance benefits.

## IV. STATEMENT OF THE CASE

This case arises out of a fire at Mount Zion Lutheran Church on May 7, 2014, which caused extensive property damage to the church building, including the sanctuary, as well as a perpendicular wing that included a kitchen, office, library, storage room, mechanical room, meeting room, restrooms, and a staircase leading to a small mezzanine. CP 231, 198-223.

At the time of the fire, Mount Zion was insured by Church Mutual under Policy Number 0067342-02-381415 ("the Policy"). CP 177, ¶3. The

Policy includes Replacement Cost coverage and has a blanket building and personal property limit of $1,099,800. *Id.*

The Policy contains the following language relevant to the "valuation" of Replacement Cost benefits:

> 7. Valuation.
>
> a. Replacement Cost. If Replacement Cost is shown in the Declarations Page as applicable to Covered Property, we will determine the value of Covered Property in the event of loss or damage as follows:
>
> (1) At Replacement Cost (without deduction for depreciation) as of the time of loss or damage . . .
>
> . . .
>
> (3) We will not pay on a Replacement Cost basis for any loss or damage:
> (a) Until the lost or damaged property is actually repaired or replaced; and
> (b) Unless the repairs or replacement are made as soon as reasonably possible after the loss or damage.
>
> (4) We will not pay more for loss or damage on a Replacement Cost basis than the least of:
> (a) The Limit of Insurance applicable to the lost or damaged property;
> (b) The cost to replace "on the same premises" the lost or damaged property with other property:
> 1) Of comparable material and quality; and
> 2) Used for the same purpose; or
> (c) The amount you actually spend that is necessary to repair or replace the lost or damaged property.

> The term "on the same premises" is a limitation on the amount of loss or damage we will pay. It does not require you to replace lost or damaged property at the same site.

CP 188.

Church Mutual retained J.S. Held Construction Consulting ("Held") to create a scope of repair and repair cost estimate. CP 177, ¶4. An insurer's repair cost estimate is intended to include all costs associated with returning the insured to its pre-loss condition. *Id.* ¶5.

Held estimated the cost of repair to be $729,106.42. *Id.*; CP 22.[1] The estimate included over 509 distinct line items, covering every area of the church building. CP 197-224. The individual line items ranged from the very significant (*e.g.*, a new complete electrical system at a cost of $51,250.00, CP 197 at line 7), to the very insignificant (*e.g.*, cabinet knobs and pulls in the kitchen, 22 of them at a unit price of $6.69, CP 202 at line 99).

The final Held estimate included the cost of replacing several arched glulam beams in the sanctuary ceiling, which had been damaged by the fire. CP 220-221. Although Held believed the beams could be made structurally

[1] Mount Zion has never agreed that the Held estimate of $729,106.42 accurately reflects all costs associated with returning Mount Zion to its pre-loss condition. However, for purposes of this appeal, the parties' disagreement as to whether the Held estimate properly captured all such costs is irrelevant. For purposes of this appeal only, Mount Zion uses the figure of $729,106.42 to represent the amount of recovery under Paragraph 7.a.(4)(b).

sound by repairing, rather than replacing, them, and included only the cost of repair in its initial estimate, Mount Zion's public adjuster, Drew Lucurell, argued that under Washington law, Mount Zion was entitled to have its sanctuary returned to its pre-fire condition, which required replacement, not merely repair, of the damaged beams. *See Moeller v. Farmers Ins. Co. of Wash.*, 173 Wn.2d 264, 275, 267 P.3d 998 (2011) ("the reasonable expectation is that following repairs, the insured will be in the same position he or she enjoyed before the accident"). Church Mutual conceded that Mount Zion was entitled to replace the beams, and Held included replacement of the beams in its final scope of repairs and repair cost estimate. CP 27 ¶9; CP 220-21.

Mount Zion retained a contractor, Seattle Remodeling Co. ("SRC"), and undertook a majority of the repairs and replacements outlined in the Held scope of repairs (hereafter "in-scope repairs"). CP 177, ¶8. However, in a few areas, Mount Zion decided against making the full repair or replacement contemplated by the Held estimate and, instead, elected to make a less expensive repair. *Id.* For example, because replacement of the arched glulam beams in the sanctuary would have required removal of the roof and added significant time to the reconstruction timeline, Mount Zion elected to refurbish rather than replace the damaged beams even though Church Mutual agreed it was entitled to brand new beams. CP 177-78, ¶8.

Mount Zion used the savings from repairing rather than replacing the beams to make desired changes to other areas of the church building that had to be rebuilt anyway as a result of the fire (hereafter "substitute expenditures"). For example, the church building (pre-fire) included a wing with a kitchen, office, library, meeting room, and restrooms. This wing was destroyed by the fire and needed to be rebuilt. In rebuilding the wing, Mount Zion made changes to the kitchen and redesigned the space to make it more functional for Mount Zion's non-worship activities. CP 178, ¶8.

The Held estimate included approximately $20,000 for repairs to the kitchen, including a new electric range ($2,431.69), new laminate countertop ($567.88), new lower cabinets ($3,489.30), new upper cabinets ($1,845.86), new sink ($460.03), and new sink faucet ($238.36). CP 202. Mount Zion used the savings from repairing rather than replacing the glulam beams to pay for upgraded kitchen cabinets, an upgraded sink and faucet, upgraded pulls and hardware, and upgraded appliances. CP 154.

The issue raised by Mount Zion's motion to the trial court, CP 233-242, was whether Mount Zion could recover as Replacement Cost proceeds the amount it *actually spent* to rebuild its church (including the perpendicular wing), including both "in-scope repairs" and "substitute expenditures," up to the amount of Held's repair cost estimate, or whether only in-scope repairs are covered by the Policy.

Resolution of this issue turns on interpretation of Paragraph 7.a.(4) of the Church Mutual Policy. This paragraph establishes the limit of what Church Mutual will pay on a Replacement Cost basis as the least of (a) the policy limit ($1,099,800); (b) the cost to replace "on the same premises" the lost or damaged property with other property of comparable material and quality and used for the same purpose (which, for purposes of this appeal, equals the Held estimate of $729,106.42[2]); or (c) the amount the insured actually spends "that is necessary to repair or replace the lost or damaged property." CP 188. Importantly, Church Mutual chose not to define the term "necessary" in the Policy, and Washington law is clear that ambiguities must be resolved in favor of policyholders and against the insurer. *Moeller,* 173 Wn.2d at 272 & 276.

The trial court held that under Paragraph 7.a.(4)(c), Mount Zion "is not entitled to Replacement Cost Coverage for any substituted costs incurred that were unnecessary to repair or replace the lost or damaged portions of the church building." CP 15. The trial court did not define the term "necessary," and so the court's holding merely reiterated the ambiguous language of the Policy, and neither affirmed nor denied that

[2] *See* footnote 1.

Mount Zion's substitute expenditures satisfied the Policy's "necessary to repair or replace" requirement.

Mount Zion filed an appeal, seeking de novo review of the trial court's decision. The Court of Appeals affirmed, holding that under Paragraph 7.a.(3)(a), "Mount Zion is not entitled to the replacement cost of glulam beams it chose not to replace," but that Mount Zion "may nevertheless be entitled to reimbursement for its 'substitute expenditures' if they were 'necessary' to replace lost or damaged property as set out in Paragraph 7.a.(4)(c)." *Mount Zion Lutheran Church v. Church Mutual Ins. Co.*, No. 78107-3-I (Div. I, Mar. 18, 2019), at 9.

Like the trial court, the Court of Appeals declined to define the term "necessary." On one hand, the Court of Appeals stated, "There is nothing in the Policy requiring Mount Zion to rebuild the church, its office, and its kitchen in the exact same configuration as existed before the fire." *Id.* at 9-10. On the other hand, the Court stated, "[T]he Policy does not impose on Church Mutual the obligation to pay for Mount Zion's remodeling choices just because the remodeled space serves the same function as the old." *Id.* at 11. The Court concluded, "Church Mutual has the contractual right to evaluate each line item of Mount Zion's insurance claim and to determine (1) whether there was lost or damaged property; and (2) whether the amount spent by Mount Zion was necessary to repair or replace that lost or damaged

property." *Id.* In other words, like the trial court, the Court of Appeals did little more than re-state the ambiguous language of the Policy, which leaves the parties back where they started – disagreeing over the proper interpretation of the word "necessary" as it appears in Paragraph 7.a.(4)(c).

## V. ARGUMENT

The Supreme Court should grant review under RAP 13.4(b)(1) and RAP 13.4(b)(4).

Review is appropriate under RAP 13.4(b)(1) because the decision of the Court of Appeals is in direct conflict with the Washington Supreme Court's decision in *Hess v. North Pacific Ins. Co.*, 122 Wn.2d 180, 89 P.2d 586 (1993), which held that an insured is not required to rebuild an "identical building on the same premises" in order to recover Replacement Cost proceeds, but rather is free to take the insurer's repair cost estimate or policy limit (whichever is less) and build a different structure on the same site or on a different site, or use the proceeds to buy an existing structure as a replacement. 122 Wn.2d at 184-85.

The Court of Appeals' decision is also in conflict with *Moeller v. Farmers Ins. Co. of Wash.*, 173 Wn.2d 264, 173 P.3d 998 (2011), which requires the court to construe ambiguities in an insurance policy in favor of the insured. Here, the Court of Appeals failed to resolve the ambiguities in Paragraph 7.a.(4)(c) in favor of the insured, Mount Zion.

Second, review is appropriate under RAP 13.4(b)(4) because this petition involves issues of substantial public interest that should be determined by the Supreme Court, including (a) the meaning of the undefined term "necessary" as it appears in the Replacement Cost Valuation provision of this Policy and countless other similar policies, which is needed to guide both insurers (in determining benefits due) and insureds (in making rebuilding decisions after a loss); and (b) efficient and common-sense use of resources when rebuilding after a fire. Because the business of insurance affects the public interest, and the outcome of this case will have an overwhelming impact on the balance of power between insurers and insureds, review by the Supreme Court is critical.

## A. The Court of Appeals' Decision is in Conflict with Decisions of the Washington Supreme Court.

### 1. The Court of Appeals' Decision Directly and Materially Conflicts with the Washington Supreme Court's Decision in *Hess v. North Pacific Ins. Co.*, 122 Wn.2d 180, 89 P.2d 586 (1993).

In *Hess,* an insured's cabin was destroyed by fire, and the insureds elected not to replace the cabin. The agreed actual cash value of the cabin was $20,000, and the agreed replacement cost was $43,182.10. The insurer paid the insureds the actual cash value of the cabin but declined to pay the additional $23,182.10 available as replacement cost proceeds. 122 Wn.2d at 182. The issue before the court was whether the insureds could collect

the full replacement cost when they had not replaced the destroyed cabin and had stipulated they did not intend to replace it. *Id.* The trial court ruled in favor of the insureds and awarded them $23,182.10. *Id.* The Court of Appeals affirmed. *Id.* After lengthy discussion of the history of replacement cost insurance, analysis of the applicable policy language, and consideration of the general principles of interpretation of insurance policies, the Supreme Court reversed and held the insureds were entitled to only the actual cash value because they had no intention of repairing or replacing the destroyed cabin. *Id.* at 188.

Although the present case involves an actual repair or replacement of the damaged structure, while *Hess* did not, the Supreme Court's analysis in *Hess* provides the framework for proper interpretation of Replacement Cost policies.

The policy at issue in *Hess* included the following relevant language:

> b. Buildings under Coverage A or B at replacement cost without deduction for depreciation, subject to the following:
>
> (1) If, at the time of loss, the amount of insurance in this policy on the damaged building is 80% or more of the full replacement cost of the building immediately before the loss, we will pay the cost to repair or replace . . . but not more than the least of the following amounts:

(a) the limit of liability under this policy that applies to the building;
(b) the replacement cost of that part of the building damaged for like construction and use on the same premises; or
(c) the necessary amount actually spent to repair or replace the damaged building.

. . .

(4) We will pay no more than actual cash value of the damage unless:
(a) actual repair or replacement is complete . . . .

*Id.* at 183-84.

The Court in *Hess* summarized these provisions as follows:

> Stated generally, subparagraphs 3.b. (1)(a), (b), and (c) set the limits of maximum liability, i.e., the lesser of (a) or (b) or (c). Those amounts reflect (a) the policy limits, (b) the replacement cost of like construction and use on the same premises, more fully explained hereafter, or (c) the amount actually spent to repair or replace the damaged building.

*Id.* at 184.

The Court also quoted with favor what it referred to as "the Jordan Report," which the Court said "cogently explains" the foregoing policy provisions as follows:

> The first measure, of course, limits the amount available for replacement to policy limits, while the second relates to a theoretical or hypothetical measure of loss: that is, the replacement cost of rebuilding the identical structure as one limit of the company's liability. ***This particular limitation does not require repair or replacement of an identical building on the same premises,*** but places that rebuilding amount as one of the measures of damage to apply in calculating liability under the replacement cost coverage.

> ***The effect of this limitation comes into play when the insured desires to rebuild either a different structure or on different premises.*** In those instances, the company's liability is not to exceed what it would have cost to replace an identical structure to the one lost on the same premises. ***Although liability is limited to rebuilding costs on the same site, the insured may then take that amount and build a structure on another site, or use the proceeds to buy an existing structure as the replacement,*** but paying any additional amount from his or her own funds.
>
> Finally, the third limitation of liability strengthens the requirement that liability of the company does not exist until repair or replacement is made. The purpose of this limitation is to limit recovery to the amount the insured spent on repair or replacement as yet another measure of the loss liability of the insurer. ***This third valuation method is intended to disallow an insured from recovering, in replacement cost proceeds, any amount other than that actually expended.***

*Id.* at 184-85 (quoting Jordan, *What Price Rebuilding?,* 19 The Brief 17, at 19-20 (Spring 1990) (emphasis added)).

Thus, under the Supreme Court's interpretation of the Replacement Cost provision in *Hess* , the Policy does not require "repair or replacement of an identical building on the same premises." When an insured desires to rebuild a different structure, "liability is limited to rebuilding costs on the same site." The insured "may then take that amount and build a structure on another site, or use the proceeds to buy an existing structure as a replacement, but paying any additional amount from his or her own funds." *Id.* According to the Court in *Hess*, the third valuation method – the necessary amount actually spent to repair or replace the damaged building

– "is intended to disallow an insured from recovering, in replacement cost proceeds, any amount other than that actually expended." *Id.*

The Court of Appeals' decision in this case directly contradicts *Hess* because it holds that "the Policy does not impose on Church Mutual the obligation to pay for Mount Zion's remodeling choices just because the remodeled space serves the same function as the old." *Mount Zion Lutheran Church v. Church Mutual Ins. Co.*, No. 78107-3-I (Div. I, Mar. 18, 2019), at 11. In fact, under *Hess*, the Policy ***does indeed*** obligate Church Mutual to pay for Mount Zion's remodeling choices, up to the amount of Church Mutual's repair cost estimate (or the policy limit, whichever is less).

Because the Court of Appeals' decision directly contradicts *Hess*, review by the Supreme Court is appropriate under RAP 13.4(b)(1).

**2. The Court of Appeals' Decision Conflicts with *Moeller v. Farmers Ins. Co. of Wash.*, 173 Wn.2d 264, 267 P.3d 998 (2011).**

In *Moeller v. Farmers Ins. Co of Wash.*, 173 Wn.2d 264, 267 P.3d 998 (2011), the Washington Supreme Court recognized certain indelible rules of construction that apply to the interpretation of an insurance policy – rules that the Court of Appeals failed to follow in this case. First, the court must view an insurance contract in its entirety and cannot interpret a phrase in isolation. 173 Wn.2d at 271. Second, ambiguities must be resolved in favor of the policyholder. *Id.* at 272. Third, the contract as a whole must be

read as the average person would read it; it should be given a "practical and reasonable rather than a literal interpretation," and not a "strained or forced construction leading to absurd results." *Id.*

Here, the Court of Appeals failed to apply these rules of construction in analyzing the issue before it. For example, the policy provision at issue here clearly states that the term "on the same premises" is a limitation on the amount of loss or damage the insurer will pay. "It does not require you to replace lost or damaged property at the same site." CP 188. Because the Policy allows an insured to replace damaged property by rebuilding on a different site, then the insured must be permitted to replace a damaged structure with one that is not identical to the one that was destroyed, as it would be virtually impossible to exactly replicate a destroyed building on another site. For the Court of Appeals to hold that Church Mutual has no "obligation to pay for Mount Zion's remodeling choices just because the remodeled space serves the same function as the old," it could not have viewed the entire policy (or even the Valuation provision) in its entirety; it could not have resolved ambiguities in favor the insured; and it could not have read the policy as an average person would read it. For these additional reasons, review is appropriate under RAP 13.4(b)(1).

### B. This Case Involves Issues of Substantial Public Interest that Should Be Determined by the Supreme Court.

#### 1. The Undefined Term "Necessary," as it Appears in This and Countless Similar Replacement Cost Policies, Must be Interpreted by the Supreme Court to Provide Guidance to Present and Future Insureds and Insurers, and the Lower Courts Have Declined to Interpret the Term.

Critical to the parties' dispute in this case is interpretation of the term "necessary," as it appears in Paragraph 7.a.(4)(c) of the Policy. Specifically, that paragraph limits Replacement Cost benefits to the amount the insured "actually spend[s] that is necessary to repair or replace the lost or damaged property."

According to Church Mutual, "necessary" in this context means "absolutely required," or "needed to bring about a certain effect or result." *See* Brief of Respondent at 20 (citing Webster's II New Riverside University Dictionary at 787 (1st ed. 1984)). Because the insurer's repair cost estimate is intended to reflect the cost of repairing the structure to its pre-fire condition, generally any item on an insured's claim that does not match up precisely with an item on the repair cost estimate will be rejected as not "necessary."

Mount Zion disagrees that insureds are strictly limited to rebuilding exactly what existed before the fire, as *Hess* states insureds are free to take the repair cost estimate (or the policy limit, whichever is less) and rebuild a

different structure on the same site or a different site, or purchase an existing structure as the replacement. Mount Zion contends that subparagraph (c) should be interpreted as allowing an insured to recover as Replacement Cost any expenditures that were "necessary" to effectuate a legally permissible replacement for the Covered Property. A legally permissible replacement would be any functionally similar structure on the same site or a different site,[3] and the term "necessary" is merely meant to prevent fraud and abuse, such as spending $10,000 on a refrigerator that is only worth $3,000, or paying a contractor $5,000 for five hours of work.

Unfortunately, although interpretation of an insurance policy is a question of law for the court, *Overton v. Consol. Ins. Co.*, 145 Wn.2d 417, 424, 38 P.3d 322 (2002), neither the trial court nor the Court of Appeals interpreted the term "necessary" as it appears in Paragraph 7.a.(4)(c). The Court of Appeals' decision, if not reviewed by the Supreme Court, leaves a complete lack of clarity and direction for the current and future insureds and insurers in trying to determine what the term "necessary" actually means. If

---

[3] *SR International Business Insurance Co. Ltd. v. World Trade Center Properties, LLC*, 445 F. Supp.2d 320, 334 (S.D.N.Y. 2006) ("In assessing whether rebuilt property constitutes a replacement, courts have determined that 'functional similarity' between a property destroyed and the replacement property is all that [a replacement cost policy] requires."); *see also Fitzhugh 25 Partners, L.P. v. KILN Syndicate KLN 501*, 261 S.W.3d 861, 864 (Ct. App. Tex. 2008); *Seeber v. General Fire and Cas. Co.*, 19 N.E.3d 402, 411-13 (Ct. App. Ind. 2014); *see also* 12 Lee R. Russ & Thomas F. Segalla, 12 Couch on Insurance 3d § 176 176:65 (1998 & Supp. 2005) (noting that even where a replacement is built at a new location, "functional similarity is all that has been required to conclude that the new property replaced the old").

an exact replica is not required, but an insured's remodeling choices are not covered even if they are in keeping with the building's pre-fire function, then how should insureds go about making rebuilding decisions after a fire, and how should insurers go about evaluating the line items on the insured's claim? Review by the Supreme Court is necessary to provide guidance and clarification to insurers and insureds.

**2. The Court of Appeals' Ruling, if Left Unreviewed, Will Result in a Tremendous Waste of Resources, as Insureds Will be Obligated to Replicate What Was Lost Rather Than Applying Current Preferences When Rebuilding After a Loss or Risk Forfeiting Replacement Cost Proceeds.**

Requiring an insured to replicate exactly what existed before the loss in order to recover Replacement Cost proceeds does not serve the interests of insureds or the members society as a whole, all of whom benefit when a rebuilt or remodeled structure can accommodate current tastes and needs. Requiring an insured to replicate what existed before the loss serves only the interests of insurers, which can now avoid liability for even the slightest changes to the building's specifications.

In addition, requiring an insured to replicate the building exactly as it existed before the loss would require regular monitoring of the reconstruction project. Such monitoring would constitute a tremendous waste of resources and make the entire adjustment process unnecessarily

cumbersome and expensive. It would also put too much power in the hands of the insurer, which could withhold funds anytime it appeared the construction project deviated in any way from replicating what existed before the fire.

These issues of public interest make it critical that the Supreme Court review the Court of Appeals' decision in this case.

## VI. CONCLUSION

Because the Court of Appeals' decision is in direct conflict with the decisions of the Washington Supreme Court in *Hess* and *Moeller*, and involves issues of substantial public interest, the Supreme Court should accept review pursuant to RAP 13.4.

Respectfully submitted this 12th day of June 2019.

Mills Meyers Swartling
Attorneys for Appellant Mount Zion Lutheran Church

By: *s/ Gretchen Graham Salazar*
Bruce A. Winchell,
WSBA # 14582
Kasey D. Huebner,
WSBA # 32890
Gretchen Graham Salazar,
WSBA # 26186

## CERTIFICATE OF FILING AND SERVICE

I, Kendra Brown, hereby certify that I filed the foregoing with the Court of Appeals, Division 1, and served same upon the following counsel of record:

Via Electronic (Email) Service:

Attorneys for Respondent (Defendant) Church Mutual Insurance Company:

Jeffrey S. Tindal
Betts Patterson & Mines, P.S.
One Convention Place, Suite 1400
701 Pike Street
Seattle, WA 98101

DATED June 12, 2019.

Kendra Brown

# APPENDIX

## UNPUBLISHED OPINION DATED MARCH 18, 2019

FILED
3/18/2019
Court of Appeals
Division I
State of Washington

IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON

| | | |
|---|---|---|
| MOUNT ZION LUTHERAN CHURCH,<br><br>Appellant,<br><br>v.<br><br>CHURCH MUTUAL INSURANCE COMPANY, a foreign corporation,<br><br>Respondent. | ) | No. 78107-3-I<br><br>DIVISION ONE<br><br>UNPUBLISHED OPINION<br><br><br><br>FILED: March 18, 2019 |

ANDRUS, J. — Mount Zion Lutheran Church appeals a summary judgment determination that its insurer, Church Mutual Insurance Company, has no obligation to reimburse it for certain costs incurred when it remodeled its fire-damaged church building. We affirm.

## FACTS

On May 7, 2014, a fire caused significant interior damage to Mount Zion Lutheran Church in Mountlake Terrace. Mount Zion was insured by Church Mutual Insurance Company under Policy Number 0067342-02-381415 (the Policy). Under the Policy, Mount Zion could collect the "Actual Cash Value" (ACV) of the "Covered Property," regardless of whether it chose to repair or replace the church. If Mount Zion chose to rebuild, it could file a claim for repair or replacement costs exceeding the ACV.

Church Mutual hired J.S. Held Construction Consulting to prepare a scope of repair and cost estimate. J.S. Held estimated the cost to replicate the church building as it existed before the fire to be $729,106.42 (the Replacement Cost Valuation or RCV). J.S. Held estimated the ACV of the church to be $593,361.66, which Church Mutual paid to Mount Zion. The Policy allowed Church Mutual to withhold the difference between the RCV and ACV, approximately $135,744, until Mount Zion completed the repairs.

J.S. Held's estimate included the cost of replacing arched glulam beams in the church sanctuary and replacing the sanctuary roof, a cost of over $196,000. Slaed Spiller, an independent adjuster hired by Church Mutual, inspected the church, including the glulam beams, and discussed their replacement with Pastor Frank Paine. Pastor Paine indicated to Spiller that he preferred to repair, rather than replace, the glulam beams, as replacement would require removal of the church's roof. Church Mutual hired Rimkus Consulting Group to assess the glulam beams, and it concluded they did not need to be replaced.

By the end of June 2014, Mount Zion had four bids, all of which reflected the cost of repairing, rather than replacing, the glulam beams. None included replacing the entire sanctuary roof. The bids ranged from $363,989, to $426,716, well below the ACV already paid to the church.

In late July 2014, Mount Zion retained a public adjuster, Drew Lucurell, to assist with its insurance claim. Church Mutual's adjuster, Spiller, testified that Lucurell claimed the glulam beams had to be replaced, rather than repaired. Although Rimkus and the four bidding contractors did not deem replacement of the

beams to be necessary, Church Mutual acquiesced and allowed Mount Zion to replace them. J.S. Held did not modify its RCV.

Mount Zion retained Seattle Remodeling Company to perform the repairs. Spiller performed a routine post-repair inspection of the church on October 28, 2015, and he discovered that the glulam beams had been repaired, not replaced.

Mount Zion prepared a replacement cost claim in April 2016 in which it reallocated the cost estimated to replace the glulam beams and sanctuary roof to a set of "substitute expenditures." The claim is not a part of the record. But Church Mutual submitted documents from Lucurell's files indicating the church spent a total of $750,682.30 in repair and replacement costs. From what we can glean from the record, the contractor granted the church a credit of $53,874 for eliminating work to replace the glulam beams, identified supplemental expenditures of $28,432, and included additional costs of $75,500 for "extras" requested by the church. Church Mutual asserts on appeal it reimbursed the church for the cost of repairing the glulam beams, but we cannot find any evidence in the record to support this contention.

Mount Zion presented evidence that it elected to refurbish, rather than replace, the arched glulam beams in the sanctuary because removing the roof would have added significant time to the reconstruction timeline. Believing it was entitled to the funds to install new glulam beams, Mount Zion chose to make "substitute expenditures" with funds otherwise allocated for the beam replacement.

For example, Mount Zion presented evidence that the original church had a perpendicular wing with offices and a small kitchenette, which were irreparably

damaged. Mount Zion chose to replace the old kitchenette with a full-size kitchen, redesigning it to make it more functional for the church's current needs. According to Lucurell's documents and Church Mutual's adjuster Spiller, the full-size kitchen had upgraded kitchen cabinets, an upgraded sink and faucets, new self-closing drawers, and upgraded appliances.

Church Mutual presented evidence that Mount Zion also upgraded the hardware on the front entry doors, upgraded the flooring and base trim in the sanctuary and foyer, upgraded wall and ceiling insulation, reframed the mezzanine for use as storage, installed underground conduits for phone and internet cables, added custom built shelving to a meeting room and classroom, refurbished a street sign not damaged in the fire, and upgraded lighting in the foyer, fellowship building, and sanctuary.

Church Mutual refused to pay the cost of replacing beams the church did not replace. It also refused to reimburse the church's "substitute expenditures" as "unnecessary" under the Policy.

Mount Zion sued Church Mutual, alleging breach of contract, breach of the duty of good faith and fair dealing, and violations of the Washington Consumer Protection Act (CPA) and Washington Insurance Fair Conduct Act (IFCA). Mount Zion filed a "motion for legal ruling regarding replacement cost coverage," arguing it was entitled under the Policy to the full amount of the RCV, regardless of its decision not to replace the sanctuary beams. The trial court denied Mount Zion's motion, holding it is "not entitled to Replacement Cost Coverage for any substituted

costs incurred that were unnecessary to repair or replace the lost or damaged portions of the church building." Mount Zion appeals.

ANALYSIS

The sole issue on appeal is whether Mount Zion is entitled to receive the full RCV calculated by Church Mutual under the Policy.

Standard of Review

This court reviews de novo an order granting or denying summary judgment. Ruvalcaba v. Kwang Ho Baek, 175 Wn.2d 1, 6, 282 P.3d 1083 (2012). The trial court's ruling was based on an interpretation of the Policy. Interpretation of an insurance contract is also a question of law we review de novo. Kut Suen Lui v. Essex Ins. Co., 185 Wn.2d 703, 710, 375 P.3d 596 (2016).

Rules of Construction or Interpretation of Insurance Contracts

This appeal involves the proper interpretation of section C, paragraph 7 of the Policy. This court construes insurance policies as contracts. Id. at 710. In construing the language of an insurance policy, its provisions must be construed together so as to give force and effect to each clause. Transcon. Ins. Co. v. Wash. Pub. Util. Dist. Util. Sys., 111 Wn.2d 452, 456, 760 P.2d 337 (1988). When this court interprets an insurance policy, it gives it "a fair, reasonable, and sensible construction as would be given to the contract by the average person purchasing insurance." Kut Suen Lui, 185 Wn.2d at 710 (internal quotation marks omitted) (quoting Key Tronic Corp. v. Aetna (CIGNA) Fire Underwriters Ins. Co., 124 Wn.2d 618, 627, 881 P.2d 201 (1994)). If the language is clear and unambiguous, the

court must enforce it as written and may not modify the contract or create ambiguity where none exists. Transcon. Ins. Co., 111 Wn.2d at 456.

Conversely, if a policy provision is, on its face, susceptible to multiple but reasonable interpretations, the policy is ambiguous, and the court must attempt to discern the intent of the parties and enforce the contract. Id. at 456-57. A court may rely on extrinsic evidence of the intent of the parties to resolve any ambiguity. Quadrant Corp. v. Am. States Ins. Co., 154 Wn.2d 165, 171-72, 110 P.3d 733 (2005). Any ambiguity remaining after examination of the extrinsic evidence is resolved against the insurer and in favor of the insured. Id. But the expectations of the insured cannot override the plain language of the contract. Id.

Relevant Insurance Provisions

Section C, paragraph 7 of the Policy provides:

**C. LOSS CONDITIONS**

. . .

7. Valuation.

> a. Replacement Cost. If Replacement Cost is shown in the Declarations Page as applicable to Covered Property, we will determine the value of Covered Property in the event of loss or damage as follows:
>
> (1) At Replacement Cost (without deduction for depreciation) as of the time of loss or damage . . .
>
> (2) You may make a claim for loss or damage covered by this insurance on an "Actual Cash Value" basis instead of on a Replacement Cost basis. In the event you elect to have loss or damage settled on an "Actual Cash Value" basis:
>
> > (a) We will then determine the value of Covered Property on an "Actual Cash Value" basis when applying the Coinsurance Condition;

> (b) You may still make a claim on a Replacement Cost basis if you notify us of your intent to do so . . .
>
> (3) We will not pay on a Replacement Cost basis for any loss or damage:
>
> **(a) Until the lost or damaged property is actually repaired or replaced; and**
>
> (b) Unless the repairs or replacement are made as soon as reasonably possible after the loss or damage.
>
> (4) We will not pay more for loss or damage on a Replacement Cost basis **than the least of:**
>
> (a) The Limit of Insurance applicable to the lost or damaged property;
>
> (b) The cost to replace "on the same premises" the lost or damaged property;
>
> 1) Of comparable material and quality; and
> 2) Used for the same purpose; or
>
> (c) The amount you actually spend that is necessary to repair or replace the lost or damaged property.
>
> The term "on the same premises" is a limitation on the amount of loss or damage we will pay. It does not require you to replace lost or damaged property at the same site.

(emphasis added).

Mount Zion contends the trial court erred in ruling it had no right to receive the full RCV amount. We conclude, however, that Mount Zion is not entitled to the full amount of the RCV because section C.7.a.(3)(a) of the Policy limits Church Mutual's obligation to pay for any loss until the lost or damaged property is actually repaired or replaced.

In Hess v. N. Pac. Ins. Co., 122 Wn.2d 180, 859 P.2d 586 (1993), the Washington Supreme Court held that an insurer had no obligation to pay full

replacement cost value of a cabin the insured chose to neither rebuild nor replace. Id. at 188. A policy provision stated that the insurer would pay no more than the actual cash value of the damage unless the "actual repair or replacement [was] complete." Id. at 184. This language unambiguously capped the insurer's liability at the actual cash value of the cabin until the cabin was repaired or replaced. Id. at 188.

Hess supports the trial court's interpretation of the Policy. As in Hess's policy, section C.7.a.(3)(a) of the Policy places a condition on Church Mutual's obligation to make any payment under section C.7.a.(4). Church Mutual has no obligation to pay on a replacement cost basis for any lost or damaged property that is not repaired or replaced. This language is not ambiguous. Mount Zion is not entitled to the replacement cost of glulam beams it chose not to replace.

Mount Zion further argues there is no basis for considering the glulam beams separately from the building to which they are attached because they are both "Covered Property" under the Policy. We disagree.

First, under section C.7.a.(2) of the Policy, the insured has the option of making a claim for loss or damage on an ACV basis instead of on a replacement cost basis. If this option is selected, section C.7.a.(2)(a) requires the insurer to determine the ACV of the "Covered Property." The "Covered Property" here is the church and all of its component parts, and the ACV reflects that value.

However, if the insured opts to make a claim on a replacement cost basis, as Mount Zion has done here, section C.7.a.(4) requires the insurer to reimburse for costs incurred to repair or replace "the lost or damaged property." It does not

require payment to repair or replace "the Covered Property." While the ACV explicitly covers the entire building and all of its component parts as one unit, the RCV explicitly covers only lost or damaged property within the Covered Property.

Second, although the Policy does not define "lost or damaged property," it uses this phrase repeatedly throughout the Policy in contexts that undercut Mount Zion's argument. For example, under section C.3.a.(4) of the Policy, insureds are required to provide "complete inventories of the damaged and undamaged property," and if possible, to set aside "damaged property" for examination by the insurer. The Policy clearly distinguishes between components of a building that have been damaged and are in need of repair or replacement from undamaged components of that same building.

It is a fair, reasonable, and sensible construction of the Policy to consider the arched glulam beams separately from the rest of the lost or damaged property within the church building when determining how to compute replacement costs due to Mount Zion.

Even though Mount Zion is not entitled to the full RCV because it did not replace the glulam beams, it may nevertheless be entitled to reimbursement for its "substitute expenditures" if they were "necessary" to replace lost or damaged property as set out in Paragraph 7.a.(4)(c).

Mount Zion argues the word "necessary" cannot be interpreted to require it to "replicate" the preexisting structure as a condition precedent to receiving replacement cost proceeds. Mount Zion is correct; there is nothing in the Policy requiring Mount Zion to rebuild the church, its office, and its kitchen in the exact

same configuration as existed before the fire. But Church Mutual is not advancing such a narrow construction of the Policy.

Mount Zion further asks this Court to adopt a "functional similarity" test in determining whether its remodeling was "necessary." It argues it should be reimbursed the full cost of its upgraded kitchen because what it built was "functionally similar" to the property lost or damaged by fire. Mount Zion relies on several federal and out-of-state cases for this argument. See Fitzhugh 25 Partners, L.P. v. KILN Syndicate KLN 501, 261 S.W.3d 861 (Tex. App. 2008) (insured's contention that purchasing an office park was a "replacement" for a multi-family apartment complex destroyed by fire was rejected because the word "replacement" in an insurance policy inherently contains the element of functional similarity); Seeber v. Gen. Fire and Cas. Co., 19 N.E.3d 402, 411-12 (Ind. App. 2014) ("replacement" coverage did not permit insured to replace destroyed commercial property with residential condominiums because properties were not used for same purpose); SR Int'l Bus. Ins. Co., Ltd. v. World Trade Cent. Prop., LLC, 445 F. Supp. 2d 320, 333 (S.D.N.Y. 2006) (in the context of determining whether non-removable tenant improvements should be included in the insurer's hypothetical replacement cost estimate, the court said "replacement property need only be 'functionally similar' to its predecessor, [and] it is inevitable that certain elements of the destroyed property will not be reproduced.").

None of these cases address the meaning of "necessary to repair or replace lost or damaged property." Nor do they conclude that an insurer is legally obligated to reimburse an insured for the cost of improvements that did not pre-exist the fire.

We conclude the Policy does not impose on Church Mutual the obligation to pay for Mount Zion's remodeling choices just because the remodeled space serves the same function as the old. Church Mutual has the contractual right to evaluate each line item of Mount Zion's insurance claim and to determine (1) whether there was lost or damaged property; and (2) whether the amount spent by Mount Zion was necessary to repair or replace that lost or damaged property.

Affirmed.

Andrus, J.

WE CONCUR:

## MILLS MEYERS SWARTLING P.S.

## June 12, 2019 - 1:16 PM

## Transmittal Information

| | |
|---|---|
| **Filed with Court:** | Court of Appeals Division I |
| **Appellate Court Case Number:** | 78107-3 |
| **Appellate Court Case Title:** | Mount Zion Lutheran Church, Appellant v. Church Mutual Insurance Co., Respondent |
| **Superior Court Case Number:** | 16-2-14154-2 |

**The following documents have been uploaded:**

- 781073_Petition_for_Review_20190612131352D1817110_8354.pdf
  This File Contains:
  Petition for Review
  *The Original File Name was 190612 Mt Zion Petn for Review SC.pdf*

**A copy of the uploaded files will be sent to:**

- aarmitage@millsmeyers.com
- bwinchell@millsmeyers.com
- jtindal@bpmlaw.com
- khuebner@millsmeyers.com
- klangridge@bpmlaw.com

**Comments:**

---

Sender Name: Kendra Brown - Email: kbrown@millsmeyers.com
**Filing on Behalf of:** Gretchen Graham Salazar - Email: gsalazar@millsmeyers.com (Alternate Email: kbrown@millsmeyers.com)

Address:
1000 Second Avenue
30th Floor
Seattle, WA, 98104
Phone: (206) 382-1000

**Note: The Filing Id is 20190612131352D1817110**