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NO. 59024-3-I
STATE OF WASHINGTON
COURT OF APPEALS, DIVISION I

LAURA HOLDEN,
Plaintiff/Respondent

v.

FARMERS INSURANCE COMPANY OF WASHINGTON, a domestic insurer; FARMERS INSURANCE EXCHANGE, a foreign insurer; and all affiliated Farmers Insurance Companies and/or entities,

Defendants/Petitioners

ON APPEAL FROM KING COUNTY SUPERIOR COURT
(Hon. John Erlick)

PLAINTIFF/RESPONDENT HOLDEN'S RESPONSE BRIEF

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ORIGINAL

TABLE OF CONTENTS

I.	OVERVIEW	1
II.	ISSUE AND REQUEST FOR RELIEF	4
III.	STATEMENT OF THE CASE	5
	A. The loss and Farmers' subsequent handling of Ms. Holden's claim	5
	B. Farmers' policies do not inform its insureds as to whether or not they will receive sales tax in an ACV settlement	6
	C. Farmers own use of the "replacement cost less depreciation method" of determining actual cash value	9
	D. Under Insurance Commissioner's Bulletin 89-3, an insurer must deal with sales taxes in good faith when settling an ACV loss	13
	E. Judge Erlick's ruling in this case	14
IV.	ARGUMENT	18
	A. An ambiguous clause in an insurance policy must be construed in favor of the insured, even though the insurer may have intended another meaning	18
	B. Farmers' reliance on <i>National Fire Insurance v. Solomon</i> is misplaced because <i>Solomon's</i> holdings have been subsequently limited to the specific facts of the case by the Washington Supreme Court	21
	C. Courts from other jurisdictions and the Washington State Insurance Commissioner concur that actual cash value settlements	

	should include sales tax	22
D.	Ms. Holden is covered for the actual cash value of her loss and is entitled to recover that sum, including sales tax, even though the insurance policy has a replacement cost option	25
E.	The <i>Berthelot</i> case relied upon by Farmers either does not apply or it supports the plaintiff's position	30
F.	Reasonable attorney's fees should be awarded on appeal	32
V.	CONCLUSION	32

TABLE OF AUTHORITIES

CASES

Baehmer v. Viking Ins. Co. of Wisconsin,
65 Wn. App. 301, 303-04, 827 P.2d 1113 (1992) 19

Boeing v. Aetna Cas. & Sur. Co.,
113 Wn.2d 869, 877, 784 P.2d 507 (1990) 18

Country Mut. Ins. Co. v. McCauley,
95 Wn. App. 306, 308, 974 P.2d 1288 (1999) 18

Credit General Ins. Co. v. Zewdu,
82 Wn. App. 620, 627, 919 P.2d 93 (1996) 25

Daley v. Allstate Ins. Co.,
135 Wn.2d 777, 784, 958 P.2d 990 (1998)..... 18

Ghoman v. New Hampshire Ins. Co.,
159 F. Supp. 2d 928, N.D. Tex. 2001) 22, 23,
24, 27,
28

Gilderman v. State Farm Ins. Co.,
437 Pa. Super. 217, 226, 649 A.2d 941, 945 (1994) 27, 28

Greer v. Northwestern Nat. Ins. Co.,
109 Wn.2d 191, 198-199, 743 P.2d 1244 (1987) 19, 20

Hess v. North Pacific Insurance Company,
122 Wn.2d 180, 859 P.2d 586 (1993) 4, 21,
23, 29

Kitsap County v. Allstate Ins. Co.,
136 Wn.2d 567, 576, 964 P.2d 1173 (1998) 18

Mazzocki v. State Farm Fire & Cas. Corp.,
766 N.Y.S.2d 719, 1 A.D.3d 9 (2003) 27

<i>National Fire Insurance v. Solomon</i> , 96 Wn.2d 763, 638 P.2d 1259 (1982)	3, 15, 21, 23
<i>Olympic Steamship Co. v. Centennial Ins. Co.</i> , 117 Wn.2d 37, 811 P.2d 673 (1991)	32
<i>Queen City Farms, Inc. v. Central Nat. Ins. Co. of Omaha</i> , 126 Wn.2d 50, 82, 882 P.3d 703 (1994)	19, 20
<i>Reese v. Northern Ins. Co. of N.Y.</i> , 207 Pa. Super Ct. 19, 22, 215 A.2d 266 (1965)	21
<i>Salesin v. State Farm Fire & Cas. Co.</i> , 229 Mich. App. 346, 367, 581 N.W.2d 781, 790, 459 Mich. 934 (1998)	27
<i>State Farm Mut Auto. Ins. Co. v. Berthelot</i> , 732 So.2d 1230 (La. 1999)	30, 31, 32
<i>State Farm Mut. Auto. Ins. v. Johnson</i> , 72 Wn. App. 580, 589, 871 P.2d 1066 (1994)	5, 19, 32

STATUTES

WAC 284-30-390(1)	31
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I. OVERVIEW

Plaintiff Laura Holden lost personal property in a fire at her apartment. Clerk's Papers (CP) 9; CP 56.¹ At the time of the fire, her residence was insured under a "Broad Form Renters Package Policy" issued by Defendant Farmers Insurance Company of Washington (Farmers). CP 55.² This policy contains a clause stating that "[c]overed loss to property will be settled at actual cash value." CP 99. The policy defines the words "actual cash value" (ACV) as meaning the "fair market value of the property at the time of the loss." CP 93. But the policy does not define the meaning of "fair market value" (FMV) or what method should be used in determining FMV.

As Farmers itself admits, several methods can be used in determining the FMV of personal property. CP 140-141.³ One method is to determine the replacement cost of the personal property item and then depreciate it. *Ibid.* Under this method, since the replacement cost of personal property assumes payment of sales tax in the State of Washington, the FMV of the item in question would also include the sales tax that would

¹ Page 26 of the Deposition of Laura Holden.

² Pages 22-23 of the Deposition of Laura Holden.

³ Pages 71-72 of the Deposition of Robert Hower.

be incurred in replacing the item. *Id.*⁴ This is the method that Ms. Holden claims Farmers should have used in this case.

Another method of determining the FMV of personal property -- the one that Farmers claims applies -- is to measure the loss by the amount of money the insured could have sold the property for before the loss, less any remaining value in the property after the loss. Under this method, FMV is defined as the amount of money that a purchaser willing but not obligated to buy would pay for the item in question to a willing seller not obligated to sell.

Following the fire, Farmers evaluated Ms. Holden's losses and assigned an ACV to these losses. But this ACV did not include any allowance for sales tax. Although she claimed that the ACV of her personal property should include sales tax, Farmers refused to pay Washington State sales tax on any portion of the ACV that it had assigned to Ms. Holden's personal property. Because Farmers refused to include sales tax in its ACV for her personal property, Ms. Holden filed this putative class action against Farmers.⁵

⁴ Page 74 of the Deposition of Robert Hower.

⁵ The putative class includes all of Farmers' insureds in the State of Washington whose fire policies define "actual cash value" as "the fair market value of the property at the time of loss" and who sustained loss or damage to personal property, submitted a contents claim to Farmers for personal property damage or loss that was settled on an actual cash value basis as opposed to exclusively on a replacement cost basis, and did not

After filing her lawsuit, Ms. Holden then sought a declaration from the trial court that the ACV assigned to her personal property by Farmers should have included Washington State sales tax. Both parties then filed summary judgment motions with the trial court.

On August 25, 2006, the trial court heard the summary judgment motions. At the hearing, Judge John Erlick agreed with Plaintiff's argument that Farmers' definition of "actual cash value," as used in Farmers' insurance policies, is ambiguous as a matter of law because it relies on a definition of FMV that is capable of more than one reasonable interpretation or construction. RP 76-79. Therefore, Judge Erlick granted Ms. Holden's Motion for Summary Judgment and denied Farmers' Motion for Summary Judgment. RP 79.⁶

Specifically, Judge Erlick found that Farmers' definition is susceptible to at least two reasonable interpretations, one of which can be read to include applicable Washington sales tax. RP 76. Based on this finding, Judge Erlick construed this contractual provision against Farmers and interpreted it in a manner favorable to Ms. Holden as including Washington sales tax. RP 79. In ruling in favor of Ms. Holden, Judge Erlick also found that the key case relied on by Farmers -- *National Fire*

receive Washington State sales tax on the entire portion of the claim settled on an actual cash value basis. CP 3-4.

⁶ The court entered an order on these cross-motions for summary judgment on September 8, 2006.

Insurance v. Solomon, 96 Wn.2d 763, 638 P.2d 1259 (1982) -- was “significantly limited,” if not overruled *sub silentio*, by the Washington Supreme Court in *Hess v. North Pacific Insurance Company*, 122 Wn.2d 180, 859 P.2d 586 (1993). RP 74-75.

Following Judge Erlick’s ruling, Farmers then moved for discretionary review of the summary judgment order in this Court. On January 16, 2007, this Court granted review.

II. ISSUE AND REQUEST FOR RELIEF

This appeal raises just one issue:

Did Judge Erlick err in finding that the definition of “actual cash value,” as defined by “fair market value,” is ambiguous with respect to whether it does or does not include sales tax?

The answer to this question is “No” -- Judge Erlick did not err. As explained both above and below, the phrase “fair market value” as used in Farmers’ Renter’s Policy is susceptible to more than one reasonable construction and is therefore ambiguous. In fact, Farmers itself gives more than one construction to the phrase and uses multiple methodologies to determine the fair market value of personal property, including the

“replacement value minus depreciation” method, which even Farmers acknowledges includes sales tax in its calculation.⁷

Washington law requires courts to resolve any ambiguity in a policy in favor of the insured. *State Farm Mut. Auto. Ins. v. Johnson*, 72 Wn. App. 580, 589, 871 P.2d 1066 (1994). Because Judge Erlick found Farmers’ definition of ACV ambiguous as to the issue of sales tax, the law required him to resolve the issue in favor of Ms. Holden and grant her summary judgment motion. Because there is no error, Judge Erlick’s order on summary judgment must be affirmed.

III. STATEMENT OF THE CASE

A. **The loss and Farmers’ subsequent handling of Ms. Holden’s claim.**

The relevant facts are undisputed. On June 9, 2004, Laura Holden suffered personal property contents losses as a result of a fire in her apartment. CP 9; CP 56.⁸ At the time of the loss, Farmers insured Ms. Holden for such a loss by operation of an insurance policy issued to her by Farmers. CP 55.⁹ Following the fire at her apartment, Ms. Holden submitted a claim to Farmers for the total loss of certain personal property

⁷ Had Farmers wanted to exclude Washington State sales tax in its computation of ACV, it could have written its policy to say so. But Farmers chose not to include this exclusion in its insurance policy.

⁸ Page 26 of the Deposition of Laura Holden.

⁹ Pages 22-23 of the Deposition of Laura Holden.

items destroyed in the fire. CP 55-58.¹⁰ Farmers paid money to Ms. Holden allegedly representing the actual cash value (ACV) of the covered portion of her personal property contents loss claim. CP 10; CP 64.¹¹ However, Farmers refused to pay Washington State sales tax on any portion of Ms. Holden's personal property contents loss. CP 70.¹²

The Farmers insurance policy issued to Ms. Holden defines ACV as the "fair market value of the property at the time of loss." CP 93. The words "sales tax" do not appear in the definition of ACV in Ms. Holden's insurance policy nor in any other Farmers insurance policy issued in the State of Washington, including, but not limited to, homeowners policies, condominium policies, or insurance policies that provide Farmers' insurance protection from personal property contents losses. Similarly, nowhere in any Farmers insurance policy issued in the State of Washington are insureds provided any written description of how Farmers goes about determining the "fair market value of the property at the time of loss."

B. Farmers' policies do not inform its insureds as to whether or not they will receive sales tax in an ACV settlement.

Farmers' authorized spokesperson, Robert Hower, testified at his deposition that one way to determine the fair market value of property at the

¹⁰ Pages 23-34 of the Deposition of Laura Holden.

¹¹ Pages 23-34 of the Deposition of Laura Holden.

¹² Pages 84-85 of the Deposition of Laura Holden.

time of loss (i.e., one way to determine ACV) is to take the replacement cost of an item and depreciate it:

Q: . . . In the state of Washington between March 14, 2001 to the present, assuming a mistake was not made, how would a Farmers claim representative determine the amount for an actual cash value settlement involving solely personal property contents?

A: Well, you could take the replacement cost less the depreciation. . . .

Q: The insured has sustained a fire and their toaster is damaged in the fire, destroyed, and as it turned out, they just purchased that toaster the day before, and they bought it for \$30 plus tax. And it's damaged in a fire the next day, so it's destroyed. How would the Farmers' claim representative determine the actual cash value of that toaster the day after it was purchased using the replacement cost less depreciation example you gave me?

. . . .

A: If it's a new toaster you're going to give them the value of a new toaster. There is no obsolescence or depreciation if it's one day old.

Q: If they paid \$30 plus tax, you would pay them \$30 plus tax; is that right?

. . . .

A: Maybe they paid too much for the toaster. Let's say they bought it at the Bon Marché. They paid \$30 for that toaster. You can go to, let's say, Costco and pay \$25 for it, or – you said \$30 – \$25 for it. That's what you'd give them.

Q: Okay. Same example. They just went to Costco the day before and they bought the cheapest toaster on the market, and that's the cheapest place you can buy it in the State of Washington, and they paid \$25 plus tax. The next day the toaster is destroyed.

How does a claim representative *determine the actual cash value settlement amount for an ACV claim* for that toaster using the replacement cost less depreciation example you gave?

A: If you're considering the age, obsolescence, condition, it's new, the settlement amount would be the value of that toaster that he paid for the day before.

Q: And that would *include the sales tax*, would it not?

A: *In that case, yes*, because you're paying the replacement cost, because there is no age, condition or obsolescence involved.

Q: And so *where do you draw the line as to how far back before you stop paying sales tax?*

A: Well, I think *you have to be reasonable*. I mean, there are depreciation charts. There are all sorts of ways of determining what the age, the condition and obsolescence of an item is to determine the market value.

Q: So there's *some reasonable cutoff that Farmers makes in determining whether they're going to include sales tax in an ACV settlement only*, and it really just kind of depends on how far along or how far back the thing was purchased; is that what you're telling me?

. . .

A: I can't give you – *there's no line that you draw in the sand*. I mean, you determine based on the item that's involved.

CP 140-141 (emphasis added).¹³

¹³ Pages 71-75 of the Deposition of Robert Hower.

In further discussion of this issue, Mr. Hower admitted that Farmers' policies do not inform its insureds as to whether or not they will receive sales tax in an ACV settlement:

Q: Where in the policy does it say that they're not going to get their sales tax [on an ACV settlement]?

A: It doesn't.

Q: And how is an insured supposed to know when Farmers is using the replacement cost less depreciation method that it doesn't include sales tax unless and until they replace?

. . .

A: That is explained to the customer at the time of the loss.

Q: So it's explained after they've already purchased the policy, but before they've made a claim?

. . .

A: I would think that sales tax, if you live in the State of Washington, you know anytime you go buy something sales tax is included, so I think that the average person would realize that sales tax is part of the ultimate replacement cost.

CP 143-144.¹⁴

C. Farmers' own use of the "replacement cost less depreciation method" of determining actual cash value.

Internal documents produced by Farmers in this litigation confirm Farmers' use of the "replacement cost less depreciation method" when determining actual cash value. These documents also reflect Farmers'

¹⁴ Pages 83-84 of the Deposition of Robert Hower.

internal dialogue as to whether sales tax should or should not be included in an actual cash value settlement:

- “Enclosed is a copy of the Property Insurance Law written by Mark Cole. This report supports our position regarding sales tax and ACV payments.” CP 192.¹⁵
- “On ACV policies, we owe taxes up front.” CP 194 - 203¹⁶
- “Home office has written a memo to ensure we are applying sales tax to our claims settlements. They advised applicable state sales tax must always be included when determining the amount of the covered loss. They also state sales tax should be included on an ACV settlement if the policy does not include a replacement cost endorsement.” CP 205.¹⁷
- “In an effort to keep everyone on the same page, we are now handling sales tax as follows: . . . on contents losses, sales tax is paid up front ONLY on the Protector Plus policy.” CP 207.¹⁸
- “HANDLING OF FIELD LOSSES – Adjustment of Contents

Actual Cash Value – Actual Cash Value is: (1) the value of property on the date of loss and is calculated as the cost of an identical new item (if unavailable, a new, like, kind and quality item) less depreciation. CP 209-211.¹⁹
- “When the insurance policy provides for the adjustment and settlement of losses on an actual cash

¹⁵ Farmers inter-office correspondence, dated March 15, 1989.

¹⁶ Washington Claims Handling Guidelines at page 5.

¹⁷ Farmers inter-office correspondence, dated December 11, 1992.

¹⁸ Farmers inter-office correspondence, dated December 16, 1997.

¹⁹ Farmers Claims Representative Field Manual.

value basis on residential fire and extended coverage, the insurer *shall* determine actual cash value as follows: replacement cost of property at time of loss less depreciation, if any.” CP 211 (emphasis added).

- “When the insurance policy provides for the adjustment and settlement of losses on an actual cash value basis on residential fire and extended coverage, the insurer shall determine actual cash value as follows: replacement cost of property at time of loss less depreciation, if any.” CP 213-214.²⁰
- “Actual Cash Value is: the value of the property on the date of loss and is calculated as the cost of an identical new item (if unavailable, a new, like, kind and quality item) less depreciation.” CP 216-218.²¹
- “Some states require that sales tax be included in AVC [sic] calculation. It is important to know the requirements of your state and comply with the proper claim handling practices for dealing with sales tax.” CP 218.
- “Bob [Hower], I’ve been paying sales tax on my partial building losses whenever I settled the claim on an actual cash value basis ‘forever’ I don’t know what others have been doing, but I don’t think I am alone in this regard.” CP 220.²²

Even though Farmers employs the “replacement cost less depreciation method” of determining actual cash value payments, Farmers has no explanation as to why the exclusion or inclusion of the payment of

²⁰ Farmers Regional Claims Manual.

²¹ Farmers Branch Claims Office Procedure Manual.

²² Internal email exchange at Farmers between Greg Ehrlich and Robert Hower.

sales tax on an actual cash value settlement is not addressed in Farmers' insurance policies:

Q: . . . I just want to know what steps Farmers took in making the determination that it was not going to include sales tax in the definition [of actual cash value].

A: I don't know.

Q: Who would know?

A: I don't know that either.

Q: Do you know whether anyone did any kind of investigation or analysis or looked into why the words sales tax were not included in the broad form renter's policy?

A: In the state of Washington?

Q: In the state of Washington.

. . .

A: No, I don't know.

. . .

Q: Do you know who at Farmers made the decision that homeowners policies did not need to contain an express exclusion of the payment of sales tax on ACV settlements?

. . .

A: No.

Q: Do you know whether any analysis, investigation was conducted in determining that an express exclusion of the payment of sales tax on ACV settlements was not needed?

. . .

A: No.

. . .

Q: Do you know whether Farmers ever requested at any time that the words sales tax be addressed or that the exclusion of payment of sales tax on ACV settlements be addressed in the definition of ACV?

...

A: I have no knowledge of that, no.

...

Q: And my question is do you know whether Farmers ever had any dialogue with the Department of Insurance as to whether it should or should not include an express exclusion for the payment of sales tax in the definition of ACV in Farmers policies?

...

A: No.

CP 126-128.²³

D. Under Insurance Commissioner's Bulletin 89-3, an insurer must deal with sales taxes in good faith when settling an ACV loss.

The issue of whether Farmers should include or exclude the payment of Washington State sales tax on personal property contents losses settled on an actual cash value basis only is not a new one. On April 5, 1989, the Office of the Insurance Commissioner issued Bulletin 89-3 ("Sales Tax and ACV Claims"). That bulletin states in part as follows:

Recently, an Insurance Law Report distributed by a Seattle law firm expressed the opinion that there is no good reason for including sales tax in actual cash value calculations. It is further asserted that the Insurance Commissioner "supports the view that sales tax should not be paid in an

²³ Pages 24, 28, and 30-31 of the Deposition of Robert Hower.

ACV loss,” except with respect to the settlement of first-party automobile total losses. As most insurers probably know, that view is *not supported* by the Commissioner.

. . .

In Washington state, sales tax amounts to a similar and substantial sum in most settlements. Its importance cannot be ignored. An insurer must deal with taxes and license fees in good faith.

CP 224 (emphasis added).

Farmers admits that it read the Insurance Law Report written by Mark Cole of the Seattle law firm of Clarke Bovingdon & Cole, and Farmers’ Privilege Log in this case reflects attorney-client communication regarding the Insurance Commissioner’s Bulletin 89-3. Incredibly, though, Farmers claims that it never received a copy of Bulletin 89-3:

Q: Is there any dispute that Farmers received that bulletin [89-3]?

A: Yes.

Q: Are you suggesting on behalf of Farmers that Farmers never received Commissioner’s Bulletin 89-3?

A: As far as we could determine, yes.

Q: You never got it?

A: That’s correct.

CP 130.²⁴

E. Judge Erlick’s ruling in this case.

On August 25, 2006, Judge Erlick heard the summary judgment motions of both parties. At the hearing, Judge Erlick rejected Farmers’

²⁴ Pages 40-41 of the Deposition of Robert Hower.

argument that FMV cannot be defined as "replacement value minus depreciation" under *National Fire Insurance v. Solomon*, 96 Wn.2d 763, 638 P.2d 1259 (1982):

The challenge here is to determine what a fair market value is, and the -- Farmers relies principally upon the case of *National Fire Insurance v. Solomon* at 96 Wn. 2d 763, a 1982 case, which expressly rejects the definition of fair market value as "replacement minus depreciation." The Court has a couple of observations with respect to reliance upon this case.

First of all, *Hess v. North Pacific Insurance Company*, in this Court's opinion, if not *sub silentio* overruling *Solomon*, at least significantly limits it. It is about as delicate of a limitation as I've ever seen, with great deference to Justice Dore, who was the writer of the *Solomon* opinion.

....

Now, the Court infers two things from this case. One is, it questions -- if you look at the other parts of the *Hess* case -- it really questions the reasoning of Justice Dore in *Solomon*, and says it relies upon, I believe, the *Reese* case, which is out of Pennsylvania; and that that Pennsylvania case has essentially been overruled.

RP at 73-75.

Judge Erlick also noted that even Farmers itself uses the "replacement minus depreciation" method -- which includes sales tax -- in determining what FMV is:

Secondly, Farmers itself -- and this is perhaps more significant -- Farmers itself appears to use the repair/replacement-minus-depreciation approach as one of multiple methodologies employed by Farmers in

determining what fair market value is. And Mr. Hower, in his deposition, indicates that the ACV, which is determined by fair market value, includes an analysis of the cost of a new item depreciated for age, obsolescence, etc.; surveying secondary markets such as eBay; appraisal by a professional appraiser; agreeing with the insured; and then other methods might depend upon the particular item involved.

Farmers acknowledges that when one uses a replacement value minus depreciation that that would include sales tax.

RP at 75-76.

Judge Erlick then granted Ms. Holden's Motion for Summary Judgment and denied Farmers' Motion for Summary Judgment, finding that Farmers' definition of "actual cash value" is ambiguous as a matter of law because it relies on a definition of FMV that is capable of more than one reasonable interpretation:

Now, there is a -- in this Court's opinion, there is a very simple resolution to this interpretation, and that is, as the parties are well aware -- if there is a reasonable construction -- or more than one reasonable construction, then a reasonable construction in favor of the insured must be applied; in other words, to be construed against the drafter of the contract -- in this case, Farmers.

....

This Court does not conclude that the definition of fair market value means "repair or replacement costs less depreciation." This Court concludes that that is one of the many definitions that must be applied. And if that is one of the definitions, and if that would require the payment of

sales tax, then that is a reasonable interpretation of fair market value.

Moreover, the Court finds Farmers' explanation of why it pays sales tax when it's actually incurred, when the policy definition doesn't change, in terms of Farmers obligation to pay actual cash value, to be somewhat inconsistent and incongruent. In other words, the definition of fair market value should be the definition of fair market value. If it requires a payment of sales -- if it doesn't require the payment of sales tax, then it is inexplicable why Farmers is paying sales tax under that same definition when it's actually incurred by the insured.

I understand that there's a redefining what the loss is; but certainly, from a reasonable-expectation standpoint of the insured, it is reasonable for an insured to expect that as part of the replacement of its policy, minus the depreciation, sales tax -- I'm sorry -- replacement of its lost item, minus depreciation -- that that would include sales tax.

The Court finds that the definition of actual cash value, as defined by fair market value, is ambiguous with respect to whether it does or does not include sales tax; that a reasonable interpretation would include compensation for sales tax, and that the ambiguity must be construed in favor of the insured.

The Court grants Plaintiff's Motion for Summary Judgment as a matter of law.

RP 76-79.

IV. ARGUMENT

A. An ambiguous clause in an insurance policy must be construed in favor of the insured, even though the insurer may have intended another meaning.

The interpretation of the meaning of an insurance policy is a question of law. *Country Mut. Ins. Co. v. McCauley*, 95 Wn. App. 306, 308, 974 P.2d 1288 (1999). In construing an insurance policy, the policy should be given a fair, reasonable, and sensible construction consistent with the understanding of an average person purchasing insurance. *Daley v. Allstate Ins. Co.*, 135 Wn.2d 777, 784, 958 P.2d 990 (1998). If terms are defined in a policy, the terms should be interpreted in accordance with that policy definition. *Kitsap County v. Allstate Ins. Co.*, 136 Wn.2d 567, 576, 964 P.2d 1173 (1998). If terms are undefined, however, they must be given their “plain, ordinary, and popular” meaning. *Boeing v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 877, 784 P.2d 507 (1990). To determine the meaning of an undefined term, courts look to the standard English language dictionary. *Ibid.* If words have both a legal, technical meaning and a plain, ordinary meaning, the ordinary meaning will prevail unless it is clear that both parties intended the legal, technical meaning to apply. *Id.* at 882.

A term is ambiguous if it is susceptible to two different but reasonable interpretations. *Kitsap County*, 136 Wn.2d at 576. Whether an

insurance policy contains an ambiguity is a question of law to be resolved by the court. *Baehmer v. Viking Ins. Co. of Wisconsin*, 65 Wn. App. 301, 303-04, 827 P.2d 1113 (1992). “Ambiguous clauses must be construed in favor of the insured, even though the insurer may have intended another meaning.” *State Farm Mut. Auto. Ins. v. Johnson*, 72 Wn. App. 580, 589, 871 P.2d 1066 (1994) (citing *Vadheim v. Continental Ins. Co.*, 107 Wn.2d 836, 840-841, 734 P.2d 17 (1987)).

In *Queen City Farms, Inc. v. Central Nat. Ins. Co. of Omaha*, 126 Wn.2d 50, 82, 882 P.3d 703 (1994), the court held that the term “sudden” in an insurance policy was ambiguous because there was more than one reasonable interpretation of the term. Because the term was ambiguous, the court resolved the ambiguity against the insurer and in favor of the insured in accord with a reasonable interpretation of the term. *Id.* at 83. Furthermore, the court noted that “[w]hen the issue is how to interpret an ambiguous policy provision, if the interpretation proposed by the insured came from the mouth of the drafter of the provision, ordinarily this would be some evidence that the proposed interpretation is reasonable.” *Id.* at 85.

Similarly, in *Greer v. Northwestern Nat. Ins. Co.*, 109 Wn.2d 191, 198-199, 743 P.2d 1244 (1987), the court found an insurance policy exclusion to be ambiguous when two reasonable contrasting

interpretations of the exclusion existed. The court noted that the exclusion could have been unambiguously drafted to exclude coverage, but instead the insurer included language subject to more than one reasonable interpretation. *Id.* at 200. Consequently, the court held that because the insurance policy term was susceptible to two or more constructions, the meaning and construction most favorable to the insured must be applied, even if the insurer intended otherwise. *Id.* at 201.

In this case, Judge Erlick correctly applied the above principles in granting Ms. Holden's motion for summary judgment. Like the ambiguous terms in *Queen City Farms, Inc.* and *Greer*, the term "fair market value" in Farmers' insurance policy is ambiguous. Farmers itself admits that it uses the "repair or replacement costs less depreciation" interpretation of fair market value as a way to determine fair market value. CP 142;²⁵ RP 75-76; Brief of Appellants at 10. As Farmers' own practices demonstrate, the undefined term "fair market value" is susceptible to more than one reasonable interpretation. Because the term "fair market value" is susceptible to more than one reasonable interpretation, Judge Erlick did not err in applying the interpretation favoring the insured as required by Washington law.

²⁵ Page 76 of the Deposition of Robert Hower.

B. Farmers' reliance on *National Fire Insurance v. Solomon* is misplaced because *Solomon's* holdings have been subsequently limited to the specific facts of the case by the Washington Supreme Court.

Farmers' principal argument in this case is that FMV cannot be defined as "replacement value minus depreciation" under *National Fire Insurance v. Solomon*, 96 Wn.2d 763, 638 P.2d 1259 (1982). See Brief of Appellants at 1-2. In making this argument, Farmers tries to distinguish *Solomon* from the Washington Supreme Court's subsequent opinion in *Hess v. North Pacific Insurance Co.*, 122 Wn.2d 180, 859 P.2d 586 (1993), by claiming that *Hess* did not address or affect *Solomon's* definition of ACV. Brief of Appellants at 13. But Farmers' argument is really against the Supreme Court itself, which made it clear in *Hess* that "[t]he facts in *National Fire Insurance v. Solomon*, 96 Wn.2d 763, 638 P.2d 1259 (1982) mandate limiting *whatever its holdings may be* to those facts and the policy involved." *Hess*, 122 Wn.2d at 191 (emphasis added).

Indeed as Judge Erlick observed,

Hess v. North Pacific Insurance Company, in this Court's opinion, if not *sub silentio* overruling *Solomon*, at least significantly limits it. It is about as delicate of a limitation as I've ever seen, with great deference to Justice Dore, who was the writer of the *Solomon* opinion.

RP 74.²⁶

²⁶ Also, as observed by Judge Erlick, the *Hess* opinion questions the reasoning of Justice Dore in *Solomon*, because *Solomon* relies upon a Pennsylvania case, *Reese v. Northern*

Because our Supreme Court has limited the holdings of *Solomon* to its facts and the specific policy involved in the case, *Solomon's* definition of fair market value does not control under the facts and policy of this case. Instead, Washington courts must look elsewhere for guidance in determining how FMV should be determined.

C. Courts from other jurisdictions and the Washington State Insurance Commissioner concur that actual cash value settlements should include sales tax.

In ruling upon the parties' summary judgment motions, Judge Erlick found the reasoning of *Ghoman v. New Hampshire Ins. Co.*, 159 F. Supp. 2d 928 (N.D. Tex. 2001), "well taken." RP 76. As in this case, the insurance policy in *Ghoman* reimbursed insureds for the actual cash value of their losses, but the policy did not define the term actual cash value. The federal district judge noted that, under Texas law, the term actual cash value was synonymous with the "fair market value" and that FMV could be determined in one of three different ways:

"Actual cash value" is not defined by the policy. Under Texas law, the term "actual cash value" is synonymous with "fair market value." "Fair market value" is the price a willing purchaser who is under no obligation to buy would pay to a willing owner who is under no obligation to sell.²⁷ This price can be quantified in one of

Ins. Co. of N.Y., 207 Pa. Super Ct. 19, 22, 215 A.2d 266 (1965), which has been overruled. RP 75.

²⁷ Judge Erlick read this quotation aloud at the summary judgment hearing and noted that "this is in concordance with Washington law." RP 77.

three ways: (1) comparable sales; (2) the income capitalization approach; or (3) the cost of repair or replacement less depreciation.

Ghoman, 159 F. Supp. 2d at 934 (citations omitted).

The federal district judge in *Ghoman* also noted that the appraiser in that case had determined the plaintiff's loss by using the replacement cost less depreciation method:

Not only do Texas courts recognize replacement cost less depreciation as an accepted method of calculating actual cash value, but the appraiser in this case determined plaintiff's loss using this method. (Def.App. at 86-87). See also Texas Dep't of Insurance, Commissioner's Bulletin No. B-0045-98 (June 12, 1998) ("The value of contractor's overhead and profit, as well as sales tax on building materials, has been included in the limit of liability for which the insured has paid premium.").

Ghoman, 159 F. Supp. 2d at 934, fn. 5.

In this case, Farmers itself uses at least two of the methods mentioned in *Ghoman* in determining FMV -- comparable sales²⁸ and the cost of repair or replacement less depreciation.²⁹ As in *Ghoman*, Farmers' own spokesperson -- Mr. Hower -- acknowledges that cost of repair or

²⁸ Judge Erlick also commented that this "is one of the methodologies used by Farmers." RP 76.

²⁹ Judge Erlick noted that this "appears to be what Farmers argues *Solomon* rejected; but appears to be questioned by *Hess*; and also appears to be one of the methodologies acknowledged by Mr. Hower as used by Farmers." RP 77.

replacement less depreciation is an acceptable method for determining the FMV of personal property losses. CP 140-141.³⁰

Also as in *Ghoman*, the Washington State Insurance Commissioner issued Bulletin No. 89-3 regarding “Sales Tax and ACV Claims”, which makes clear that settlements for ACV should include sales tax. CP 224. The Insurance Commissioner issued this Bulletin in response to an Insurance Law Report distributed by a Seattle law firm. The Law Report asserted that the Insurance Commissioner “supports the view that sales tax should not be paid in an ACV loss,” except with respect to the settlement of first party automobile total losses. CP 224. Disagreeing with that view, the Insurance Commissioner issued the Bulletin, stating in part as follows:

WAC 284-30-390 specifically requires the payment of all applicable taxes, license fees and other fees incident to transfer of evidence of ownership, in only first party, private passenger automobile total loss situations. *It does not follow, however, that taxes need not be considered in other cases, whether the loss is total or partial or owed to a first or third party claimant.*

...

In Washington State, sales tax amounts to a similar and substantial sum in most settlements. Its importance cannot be ignored. An insurer must deal with taxes and license fees in good faith. If we find that this is not being done, additional rules will follow.

CP 224 (emphasis added).

³⁰ Pages 71-75 of the Deposition of Robert Hower.

Although a commissioner, whether by declaratory order, letter, or bulletin, cannot bind the courts, the court appropriately defers to a commissioner's interpretation of insurance statutes and rules. *See Credit General Ins. Co. v. Zewdu*, 82 Wn. App. 620, 627, 919 P.2d 93 (1996) (deferring to a declaratory order issued by the Insurance Commissioner) (citing *Baily v. Allstate Ins. Co.*, 73 Wn. App. 442, 447, 869 P.2d 1110 (1994) (deferring to a letter issued by the Insurance Commissioner regarding the interpretation of a statute)). Deference is appropriate when the agency is charged with responsibility for administering the insurance laws of Washington. *Id.* Thus, the Insurance Commissioner's Bulletin provides yet further guidance regarding whether or not ACV settlements should include sales tax and, as in *Zewdu* and *Baily*, the Court should defer to the Insurance Commissioner's Bulletin that actual cash value settlements require payment of sales tax.

D. Ms. Holden is covered for the actual cash value of her loss and is entitled to recover that sum, including sales tax, even though the insurance policy has a replacement cost option.

This is an issue of first impression. No Washington case has determined whether sales tax should be included in a payment for property loss settled on an actual cash value basis. The Farmers policy defines "actual cash value" as "the fair market value of the property at time of loss." CP 93. The policy neither defines "fair market value," nor sets out

the method by which Farmers determines ACV or FMV. Nevertheless, Farmers admits that one reasonable method of determining ACV or FMV is the “replacement cost less depreciation method.” CP 140-141;³¹ RP 75-76.

Farmers’ insurance policy gave Ms. Holden the election to settle her personal property loss claim on an ACV or replacement cost basis. Replacement cost by definition is a greater dollar amount than actual cash value and includes the price to repair or replace the covered property *without deduction for depreciation*. CP 118. Farmers concedes that ACV, by contrast, can be replacement cost of a new item *less depreciation*. Nowhere in Farmers’ policy does it state that ACV excludes payment of sales tax, nor does it state that Farmers may withhold sales tax in ACV settlements. If Farmers wanted to exclude Washington State sales tax in its computation of ACV, all it had to do was say so in its policy. But Farmers did not specify in its insurance policy that it does not include sales tax in ACV settlements.

Despite the silence in its policy regarding the payment of sales tax, Farmers argues that it does not have to include sales tax in an ACV settlement unless the insured actually pays sales tax in replacing the item of personal property under the policy’s replacement cost option. *See* Brief

³¹ Pages 71-75 of the Deposition of Robert Hower.

of Appellants at 14-16. But jurisdictions that have considered the issue have consistently held that insurers, like Farmers, cannot withhold payment of sales tax from property loss claims settled on an ACV basis even if the insurance policy has a replacement cost option. *See Salesin v. State Farm Fire & Cas. Co.*, 229 Mich. App. 346, 367, 581 N.W.2d 781, 790 (1998) (holding that insurer could not deduct contractor's overhead and profit from "actual cash value"), *review denied*, 459 Mich. 934 (1998); *Gilderman v. State Farm Ins. Co.*, 437 Pa. Super. 217, 226, 649 A.2d 941, 945 (1994) (holding that insurer could not deduct contractor's overhead and profit from "actual cash value"), *review denied*, 541 Pa. 626 (1995); *Ghoman v. New Hampshire Ins. Co.*, 159 F. Supp. 2d 928 (N.D. Tex. 2001) (finding that overhead, profit, and sales tax should be included in the actual cash value reward); *Mazzoeki v. State Farm Fire & Cas. Corp.*, 766 N.Y.S.2d 719, 1 A.D.3d 9 (2003) (holding that profit and overhead must be included in actual cash value payments).

For example, in *Ghoman*, the issue was whether an insurer, which had agreed to pay repair or replacement costs less depreciation in advance of actual repair or replacement of a covered loss, may automatically withhold depreciation *and* contractor's overhead, profit, and sales tax. The insurer, like Farmers in this case, contended that advance payment of overhead, profit, and sales tax is unfair because the insured had not

actually incurred such costs, and that payment for contractor's overhead, profit, and sales tax is contingent on the insured actually incurring such costs. The Texas court rejected this argument, however, finding that whether overhead and tax are actually incurred is legally irrelevant under the replacement cost less depreciation method. The *Ghoman* court then held that "[w]hat plaintiff actually spent to repair his property – indeed, whether he repaired the property at all – does not affect his right to recover actual cash value. . . . Plaintiff was covered for the actual cash value of his loss and is entitled to recover that sum." *Ghoman*, 159 F. Supp. 2d at 935.

The Pennsylvania court reached a similar conclusion in *Gilderman*:

All repair or replacement costs are, in theory, "contingent" prior to being incurred. . . . [Accordingly] the issue is not whether a given cost is contingent. The issue is what [the insurer] agreed to pay to its insureds prior to actual repair or replacement. It agreed to pay "actual cash value" which means "repair or replacement cost less depreciation." Thus, the real inquiry is what is included in "repair or replacement costs." ***We hold that repair or replacement costs include any cost that an insured is reasonably likely to incur in repairing or replacing a covered loss.***

Gilderman, 649 A.2d at 945 (emphasis added).

As courts in other jurisdictions have determined, repair and replacement costs include sales tax because an insured is reasonably likely to incur sales tax in repairing or replacing a covered loss regardless of whether or not the policy in question included a replacement cost option.

After all, the price of anything -- a car, a chair, or a shirt -- necessarily includes sales tax as a component of the purchase price.

A major public policy underlying the tenets of insurance is that of “making the insured whole” after the insured incurs property damage or loss. *See Hess v. North Pacific Ins. Co.*, 122 Wn.2d 180, 182-83, 859 P.2d 586 (1993) (holding that the underlying purpose of property insurance is indemnity). The intent of the law is to place plaintiff in the same position she was in prior to the property damage – not in a better or worse position. The sales tax should logically be considered as necessary to place the plaintiff in that same position.

The objective of making the plaintiff whole when assessing property damage claims requires that the insured receive a payment equal to that of the covered loss so that the insured will be restored to the same position after the loss as before. A sales tax is a mandatory cost that state and local governments have added to transactions for goods and services. The inclusion of sales tax is a part of every transaction and, therefore, is necessary to make the plaintiff whole. The calculation of a property damage claim results in under-compensation if an insurer deducts sales tax, as sales tax represents part of the insured’s loss.

There is no compelling reason that an insured, who has a reasonable expectation of being compensated for the entire value of the

contents of her home under her insurance policy, should be left in a monetarily worse position than before experiencing a loss covered by an insurance policy. In this case, Ms. Holden should be entitled to recover the actual cash value of her loss, including sales tax, even though the insurance policy has a replacement cost option, and Farmers should be obligated to pay sales tax in any ACV settlement as a matter of law.

E. The *Berthelot* case relied upon by Farmers either does not apply or it supports the Plaintiff's position.

Farmers' reliance on *State Farm Mut. Auto. Ins. Co. v. Berthelot*, 732 So.2d 1230 (La. 1999), is misplaced and at odds with Washington law. *Berthelot* dealt with losses under automobile insurance policies and held that sales tax should not be included in actual cash value computations involving automotive losses. In contrast, WAC 284-30-390(1) requires that sales tax must be included in actual cash value settlements involving total losses to automobiles. In Washington, there is a public policy set forth by regulation that insurers must pay sales tax on ACV settlements involving automobiles. Apparently, Louisiana has a contrary public policy. In addition, a Louisiana court cannot comment on Washington's public policy with regard to the payment of sales tax on ACV claims. Furthermore, the Insurance Commissioner's Bulletin 89-3

clearly evidences a public policy in favor of paying sales tax on ACV settlements.

In addition, the *Berthelot* case actually supports Plaintiff's position. If a state has a public policy favoring the inclusion of sales tax in an ACV settlement for automobiles (as Washington does), then insureds can reasonably assume payment of sales tax on other ACV settlements. In contrast, when a state, like Louisiana, does not evidence its public policy in favor of paying sales tax on ACV settlements, insureds could assume that sales tax on ACV settlements will not be paid. Given Washington's public policy in favor of paying sales tax on ACV settlements (as evidenced by WAC 284-30-390(1) and Insurance Commissioner Bulletin 89-3), the average purchaser of insurance in the state of Washington can reasonably assume sales tax will be paid on ACV settlements.

While one can argue that the *Berthelot* case in fact supports the Plaintiff's position here, one can also argue that the *Berthelot* case has no applicability whatsoever because the *Berthelot* court did not address the ambiguity issue central to this litigation. Here, the question is whether or not Farmers' definition of ACV in the insurance policies it sold in this state is ambiguous when read by the average purchaser of insurance. The *Berthelot* court did not address this issue. Moreover, the *Berthelot* court did not address how the average purchaser of insurance would interpret

“fair market value at the time of loss.” As such, the *Berthelot* case does not apply.

F. Reasonable attorney’s fees should be awarded on appeal.

Plaintiff requests an award of reasonable attorney’s fees on appeal pursuant to *Olympic Steamship Co. v. Centennial Ins. Co.*, 117 Wn.2d 37, 811 P.2d 673 (1991) and RAP 18.1.

V. CONCLUSION

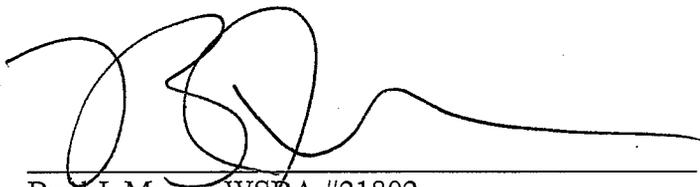
Washington law requires courts to resolve any ambiguity in an insurance policy in favor of the insured. *State Farm Mut. Auto. Ins. v. Johnson*, 72 Wn. App. 580, 589, 871 P.2d 1066 (1994). Based on this well established principle of law, the sole issue in this appeal is whether or not Judge Erlick erred in finding Farmers’ insurance policy ambiguous in its definitions of ACV and FMV.

As set forth above, the “fair market value” of personal property may be ascertained in several different ways, one of which includes the “replacement minus depreciation” method that includes a reimbursement for sales tax. Indeed, Farmers itself uses this method to calculate the FMV of personal property in some instances.

Because Farmers’ insurance policy fails to specify which method should be used in determining an item’s FMV, it is ambiguous. Based on this ambiguity, Judge Erlick correctly resolved the issue in favor of Ms.

Holden and properly granted her summary judgment motion. For this reason, as well as those set forth above, Judge Erlick's order on summary judgment in favor of Ms. Holden must be affirmed.

Respectfully submitted this 31st day of July 2007.

A handwritten signature in black ink, appearing to be 'BJM', written over a horizontal line.

Brad J. Moore, WSBA #21802
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CERTIFICATION

I hereby certify that on July 31, 2007, I delivered a copy of the document to which this certification is attached to ABC Legal Messengers for delivery to all counsel of record as follows:

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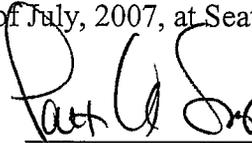
VIA HAND DELIVERY

A copy was also provided to out-of-state co-counsel for defendant as follows:

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Dated this 31st day of July, 2007, at Seattle, Washington.



Patti A. Sims

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