

85856-0

FILED

APR 04 2011

COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

FILED
APR 13 2011
CLERK OF THE SUPREME COURT
STATE OF WASHINGTON

NO. 289541

SUPREME COURT OF THE STATE OF WASHINGTON

REX AND BRENDA ALLEMAND, husband and wife,

Petitioners,

v.

STATE FARM INSURANCE COMPANIES, also known as
STATE FARM GENERAL INSURANCE COMPANY; and
STATE FARM FIRE & CASUALTY COMPANY,

Respondents.

PETITION FOR REVIEW

Douglas W. Nicholson, WSBA #24854
Cone Gilreath Law Offices
Attorneys for Petitioners
200 E. Third Avenue
P.O. Box 499
Ellensburg WA 98926
(509) 925-3191

TABLE OF CONTENTS

	<u>Page</u>
A. IDENTITY OF PETITIONERS	1
B. COURT OF APPEALS DECISION.....	1
C. ISSUES PRESENTED FOR REVIEW	1
D. STATEMENT OF THE CASE	3
E. SUMMARY OF ARGUMENT.....	5
F. ARGUMENT WHY REVIEW SHOULD BE ACCEPTED	
1. This Case Meets the Requirements for Review.....	7
2. The Efficient Proximate Cause Rule Applies to Ex- tend Coverage if the Predominant Cause of the Loss is an Insured Peril, Even if Another Event in the Chain of Causa- tion is a Specifically Excluded Peril	9
3. The Allemands’ State Farm Homeowners’ Policy Effectively Circumvents the Efficient Proximate Cause Rule, Because the Entire Fire Loss Would Have Been Cov- ered Had the Allemands Not Paid Extra for the Optional Building Ordinance and Law Coverage.....	11
4. As Construed by the Court of Appeals, the Optional Building Code Enforcement Coverage is Illusory Since, in Light of the Efficient Proximate Cause Rule, the Allemands Received No Benefit in Paying for This Additional Cover- age; Thus, There Was No Consideration for Their Payment.....	14
5. The Insurance Policy’s Language is Ambiguous.....	16

G. CONCLUSION 19

APPENDICES

TABLE OF AUTHORITIES

CASES

Allstate Ins. Co. v. Raynor, 143 Wn.2d 469, 21 P.3d 707
(2001) 9

American Nat'l Fire v. B&L Trucking & Constr. Co., 134
Wn.2d 413, 951 P.2d 250 (1998)..... 16

Boeing v. Aetna Casualty & Surety Co., 113 Wn.2d 869,
784 P.2d 507 (1990) 19

Dairyland Ins. Co. v. Ward, 83 Wn.2d 353, 517 P.2d 966
(1974)15-16

Dombrosky v. Farmer's Ins. Co., 84 Wn. App. 245,
928 P.2d 1127 (1996), *review denied*, 131 Wn.2d 1018
(1997) 8

Findlay v. United Pacific Ins., 129 Wn.2d 368, 917 P.2d
116 (1996).....9-10, 12

Garvey v. State Farm Fire & Cas. Co., 48 Cal.3d 395,
770 P.2d 704, 257 Cal. Rptr. 292 (1989)..... 12

Graham v. Pemco, 98 Wn.2d 533, 656 P.2d 1077 (1983) 9, 15

Key Tronic Corporation v. Aetna, 124 Wn.2d 618,
881 P.2d 201 (1994)9-10

Kish v. Insurance Co. of N. Am., 125 Wn.2d 164, 883 P.2d
308 (1994)..... 9, 11

<i>McDonald v. State Farm</i> , 119 Wn.2d 724, 837 P.2d 1000 (1992).....	9-10
<i>Roberts v. Allied Group Insurance Co.</i> , 79 Wn. App. 323, 901 P.2d 317 (1995)	8
<i>Safeco Insurance v. Hirschmann</i> , 112 Wn.2d 621, 773 P.2d 413 (1989).....	9-11, 15-16
<i>St. John Med. Ctr. v. Dep't of Soc. & Health Servs.</i> , 110 Wn. App. 51, 38 P.3d 383 (2002), <i>review denied</i> , 146 Wn.2d 1023 (2002)	14
<i>Starczewski v. Unigard Insurance Group</i> , 61 Wn. App. 267, 810 P.2d 58 (1991), <i>review denied</i> , 117 Wn.2d 1017 (1991)	8, 18
<i>Taylor v. Shigaki</i> , 84 Wn. App. 723, 930 P.2d 340 (1997), <i>review denied</i> , 132 Wn.2d 1009 (1997)	14
<i>Villella v. Pemco</i> , 106 Wn.2d 806, 725 P.2d 957 (1986)	9-12, 15

RULES AND STATUTES

RAP 13.4(b)(1), (2) & (4).....	7-8
--------------------------------	-----

OTHER AUTHORITIES

<i>Webster's New World Dictionary (2d College Ed.)</i>	15
--	----

A. IDENTITY OF PETITIONERS

Rex and Brenda Allemand (“Allemands”) ask this Court to accept review of the Court of Appeals’ published decision terminating review designated in Part B of this petition.

B. COURT OF APPEALS’ DECISION

Petitioners seek review of the decision of the Court of Appeals (Division Three), filed March 3, 2011 (No. 28954-1-III). No motion for reconsideration was sought before the Court of Appeals. A copy of the published decision is found in the attached Appendix A.

C. ISSUES PRESENTED FOR REVIEW

No. 1: Under an all-risk homeowners’ insurance policy, if the predominant cause of a loss is a covered peril (in this case, fire), does the efficient proximate cause rule still apply to extend coverage even though another event in the chain of causation (in this case, building ordinance or law enforcement) is clearly excluded from coverage?

Sub-Issue: If so, does the insurance policy’s offer of optional coverage for the exclusion conflict with, or circumvent, the efficient proximate cause rule where the optional coverage, if purchased by the insured, operates to reduce the coverage that would have otherwise been available had the insured not purchased the optional coverage? (This is an issue of first impres-

sion in Washington state.)

Sub-Issue: In light of the efficient proximate cause rule, does the insured's purchase of optional coverage for the exclusion render the policy illusory where the optional coverage operates to reduce the amount of coverage that would have otherwise been available to cover the loss had the insured not purchased the optional coverage? (This also appears to be an issue of first impression, at least with respect to the language of State Farm's standard homeowners' policy.)

Sub-Issue: Did the Court of Appeals err in finding that Coverage A of the insurance policy recognizes the efficient proximate cause rule, and actually applies the rule to cover building code upgrades that are required when repairing a covered loss?

No. 2: Is the relevant policy language ambiguous; that is, is it subject to more than one reasonable interpretation?

Sub-Issue: If so, does a fair and reasonable interpretation of the Allemands' all-risk homeowners' policy establish that the optional code enforcement coverage (Option OL) applies only to the costs of the actual code upgrades themselves, and not as a second cap on the amount available under Coverage A to replace the dwelling?

D. STATEMENT OF THE CASE

The Allemands owned a house in Kittitas, Washington, that was severely damaged by an accidental fire on June 20, 2007. CP 27, 45. The Allemands' house was insured under an all-risk homeowners' insurance policy issued by State Farm. CP 19-24, 51-54. The house was originally built in 1940. CP 44. When the fire occurred, the Allemands' house did not comply with current local building code requirements applicable to its foundation, crawl space, and electrical wiring. CP 27-28. Due to those deficiencies, the Allemands could not obtain a building permit to simply repair the portions of their house that were damaged or destroyed by the fire; instead, they had to tear down the entire house, including the undamaged portions, and rebuild and replace it from scratch. CP 45. The parties stipulated that the replacement cost of the house was \$96,669.56. CP 82.

The Allemands' State Farm homeowners' policy provided a maximum of \$89,866 under Coverage A to repair or replace their home "with similar construction." CP 27. Under the loss settlement provisions applicable to Coverage A (dwelling), the policy excluded the "increased costs resulting from enforcement of any ordinance or law regulating the construction, repair or demolition of a building or other structure, except as provided under **Option OL – Building Ordinance or Law Coverage.**" CP 23 (emphasis origi-

nal). The additional coverage under Option OL provided an additional sum, equal to 10% of the policy maximum, for costs resulting from building code enforcement. CP 20. The Allemands purchased the “additional coverage” provided by Option OL. CP 20.

State Farm paid the Allemands the total amount of \$59,663.55. CP 28-29. This amount consisted of the estimated amount to repair only the damaged portion of the Allemands’ house under Coverage A (without considering the fact that the entire house, including the undamaged portion, had to be completely demolished and replaced to comply with current building code requirements), plus the \$8,986.60 limit available for code upgrades under Option OL. CP 28-29, 45.

The Allemands then filed an action for declaratory judgment and damages, arguing that State Farm was required to pay the maximum under both Coverage A and Option OL. CP 1-3. The trial court agreed with the Allemands’ interpretation of the policy; it thus awarded the Allemands an additional \$37,001 under the policy, and directed State Farm to pay for their attorneys’ fees and statutory costs. CP 98.

The Court of Appeals reversed the trial court’s judgment. *See* Appendix A at 10. In doing so, the court held that the homeowners’ insurance policy is unambiguous; that State Farm’s obligation under Coverage A is li-

mitted to providing “similar construction” in rebuilding the home; and that the phrase “similar construction” does not include paying for required code upgrades; instead, the policy provides for necessary upgrades under Option OL, which is “the sole source of [State Farm’s] obligation to pay for bringing the remodeled home up to code”, and which is limited to 10% of the Coverage A limit applicable to the dwelling. *See* Appendix A at 9.

Finding that “Coverage A of the policy expressly indicates that it does cover building code upgrades caused by the same loss only under optional OL Coverage and to the extent provided in that coverage”, the court stated, at footnote 2, that “[t]his provision recognizes the efficient proximate cause rule The policy actually applies the rule and covers building code upgrades that are required when repairing a covered loss.” *See* Appendix A at 8-9.

E. SUMMARY OF ARGUMENT

The efficient proximate cause of the damage to the Allemands’ home was an accidental fire, a covered peril under Coverage A of their all-risk homeowners’ policy. The policy’s loss settlement provisions applicable to Coverage A exclude increased costs caused by the enforcement of any ordinance or law regulating the construction or repair of the house, unless the insured pays an additional premium to acquire such coverage under Option OL. If the policy simply contained a blanket exclusion for the increased costs

caused by building ordinance or law enforcement, the efficient proximate cause rule would apply in this case to extend coverage for the entire fire loss.

The same result would hold if the Allemands *had not* paid extra to make Option OL part of their policy. By doing so, the Allemands paid more for this ostensible “additional coverage”, but in fact unknowingly received less coverage for their additional payment. As such, the purported additional coverage extended under Option OL is illusory and, in effect, circumvents the efficient proximate cause rule.

Furthermore, the Allemands’ State Farm policy is ambiguous. A fair and reasonable interpretation of the relevant provisions of the policy is that Option OL is a separate coverage provision, which provides “additional insurance” to pay for legally required code upgrades. As such, Option OL’s coverage limit operates only as a cap on the amount State Farm will pay for the actual costs of the code upgrades themselves; it does not otherwise limit the coverage available for the dwelling under Coverage A of the policy.¹

1. The Court of Appeals incorrectly found that, “[t]he necessary upgrades required more than [the 10% limit of Coverage A] and State Farm thus properly tendered its limits under that coverage [Option OL].” Nothing in the record supports this finding, as no evidence was presented as to what the actual code upgrades themselves cost. Moreover, irrespective of the code upgrades, the Allemands’ entire house, including the *undamaged portions*, had to be razed. Thus, under the Court of Appeals’ ruling, the Allemands were not compensated for the loss to the undamaged portion of their home, even though the fire was the efficient proximate cause of that loss.

F. ARGUMENT WHY REVIEW SHOULD BE ACCEPTED

1. This Case Meets the Requirements for Review.

This petition involves an issue of first impression in Washington, which is a matter of substantial public interest that should be determined by this Court under RAP 13.4(b)(4). State Farm's all-risk homeowners' policy is a standard form, adhesion contract that covers accidental fire loss, but excludes increased costs caused by building code enforcement, unless the insured pays an additional premium for optional code enforcement coverage. The policy limit for this optional coverage, however, is only 10% of the coverage limit available for the dwelling under Coverage A. The entire loss would have been covered under the efficient proximate cause rule had the Allemands declined to pay for the optional code upgrade coverage; thus, the optional coverage is illusory: the Allemands paid more, but in fact received less coverage under the Court of Appeals' construction of the policy. Furthermore, this outcome has the effect of circumventing the efficient proximate cause rule; it also defeats the purpose of the rule and the reason for purchasing an all-risk homeowners' policy.

The impact of this outcome is not limited to the Allemands; rather, it likewise affects all holders of State Farm's standard form all-risk homeowners' policy in this state, as well as the policy holders of similar insurance pol-

icies issued by other insurers in this state.

Moreover, the Court of Appeals' decision in this case is in conflict with the efficient proximate cause rule as articulated by this Court; therefore, review is also appropriate under RAP 13.4(b)(1). The court's decision is also in conflict, or at least difficult to reconcile, with Division One's decision in *Starzewski v. Unigard Insurance*, 61 Wn. App. 267, 810 P.2d 58 (1991), *review denied*, 117 Wn.2d 1017 (1991). Indeed, in this case, the Court of Appeals itself stated, "Not surprisingly, the parties can each find some support for their position in existing case law." Appendix A at 4. Accordingly, review is also appropriate under RAP 13.4(b)(2).²

This Court should also take the opportunity to reaffirm its commitment to the efficient proximate cause rule and make clear that unambiguous policy exclusions or limitations on coverage, however worded, may not be permitted to override or undermine the rule, at least with respect to adhesion contracts in the all-risk homeowners' policy setting. In this context, absent extrinsic evidence of both the insured's and the insurer's intent, the efficient

2. In attempting to distinguish *Starzewski*, relied on by the Allemands, from *Roberts v. Allied Group Insurance Co.*, 79 Wn. App. 323, 901 P.2d 317 (1995) and *Dombrosky v. Farmer's Ins. Co.*, 84 Wn. App. 245, 928 P.2d 1127 (1996), *review denied*, 131 Wn.2d 1018 (1997), relied on by State Farm, the Court of Appeals did not address the fact that the outcome in *Starzewski* turned upon the application of the efficient proximate cause rule, whereas neither the *Roberts* nor *Dombrosky* decisions addressed the rule, which, had it been raised and addressed, might have resulted in a different outcome.

proximate cause rule should be applied predictably and uniformly.

2. The Efficient Proximate Cause Rule Applies to Extend Coverage if the Predominant Cause of the Loss is an Insured Peril, Even if Another Event in the Chain of Causation is a Specifically Excluded Peril.

This Court first adopted the efficient proximate cause rule in *Graham v. Pemco*, 98 Wn.2d 533, 656 P.2d 1077 (1983). Under the rule, “where an insured risk itself sets into operation a chain of causation in which the last step may have been an excepted risk, the excepted risk will not defeat recovery.” *Villella v. Pemco*, 106 Wn.2d 806, 815, 725 P.2d 957 (1986). This Court has expressly reaffirmed its commitment to the efficient proximate cause rule in each decision since *Graham* and *Villella*. See *Safeco Insurance v. Hirschmann*, 112 Wn.2d 621, 625-26, 773 P.2d 413 (1989); *McDonald v. State Farm*, 119 Wn.2d 724, 731, 837 P.2d 1000 (1992); *Key Tronic Corporation v. Aetna*, 124 Wn.2d 618, 625-26, 881 P.2d 201 (1994); *Kish v. Insurance Co. of N. Am.*, 125 Wn.2d 164, 169-170, 883 P.2d 308 (1994); *Findlay v. United Pacific Ins.*, 129 Wn.2d 368, 372-74, 917 P.2d 116 (1996); *Allstate Ins. Co. v. Raynor*, 143 Wn.2d 469, 479-80, 21 P.3d 707 (2001).

This Court has also made clear that an insurer cannot defeat the application of the efficient proximate cause rule by drafting exclusionary language to circumvent it. *Hirschmann*, 112 Wn.2d at 627; *Key Tronic Corporation*,

124 Wn.2d at 626; *Findlay*, 129 Wn.2d at 375 (“insurer could not, by drafting a variation in exclusionary clause language, deny coverage when a *covered peril* sets in motion a causal chain the last link of which is an excluded peril”) (citing *Hirschmann*, 112 Wn.2d at 626-27 (italics original)).

The efficient proximate cause rule, however, does not apply to extend coverage “[i]f the efficient proximate cause . . . is a specifically named, unambiguous excluded peril in the policy.” *Findlay*, 129 Wn.2d at 380. “[I]n a chain of causation case, the efficient proximate cause rule is properly applied after (1) a determination of which single act or event is the efficient proximate cause of the loss, and (2) a determination that the efficient proximate cause of the loss is a covered peril.” *Findlay*, 129 Wn.2d at 376 (citing *McDonald*, 119 Wn.2d at 732).

Where, as here, the efficient proximate cause of the loss is a covered peril, even a specific, unambiguous exclusion will not defeat coverage for the entire loss, even if the excluded event contributed to or aggravated the loss. *Villella*, 106 Wn.2d at 819. In *Villella*, the earth movement exclusion unambiguously covered landslide and mudflow. *Id.* at 809. Despite this unambiguous exclusion, this Court held that it would not defeat coverage if the alleged negligently constructed drainage system (a covered peril) was the efficient proximate cause of the loss: “If so, the earth movement exclusionary

clause would *not* exclude coverage.” *Id.* at 819 (italics original); *see also*, *Hirschmann*, 112 Wn.2d at 629.

Here, the Allemands’ State Farm policy specifically excludes costs caused by the enforcement of a building ordinance or law, unless the insured pays an additional premium for the optional building ordinance or law coverage extended under Option OL of the policy. Even if the relevant language of the policy is found to be unambiguous, it should not defeat coverage for the entire loss in this case, since the efficient proximate cause of the loss was an accidental fire, a covered peril. Further support for this conclusion will be set forth in the following section.

3. The Allemands’ State Farm Homeowners’ Policy Effectively Circumvents the Efficient Proximate Cause Rule, Because the Entire Fire Loss Would Have Been Covered Had the Allemands Not Paid Extra for the Optional Building Ordinance and Law Coverage.

Under the efficient proximate cause rule, “[i]f the initial event, the ‘efficient proximate cause,’ is a covered peril, then there is coverage under the policy regardless whether subsequent events within the chain, which may be causes-in-fact of the loss, are excluded by the policy.” *Hirschmann*, 112 Wn.2d at 628. “[T]he purpose of the efficient proximate cause rule is to provide a ‘workable rule of coverage that provides a fair result within the reasonable expectations of both the insured and the insurer’”. *Kish*, 125 Wn.2d

at 172 (quoting *Garvey v. State Farm Fire & Cas. Co.*, 48 Cal.3d 395, 404, 770 P.2d 704, 257 Cal. Rptr. 292 (1989)); *Findlay*, 129 Wn.2d at 377.

Here, State Farm, which is in the business of insurance and drafting insurance policies, can be reasonably expected to be aware of the efficient proximate cause rule and its application in insurance policy construction. The Allemands, however, cannot be reasonably expected to be aware of the rule and its application. State Farm's all-risk homeowners' policy defeats the purpose of the efficient proximate cause rule, because it provides an *unfair result*: the Allemands paid more for Option OL, ostensibly to provide "additional coverage" for losses caused by building code enforcement, an otherwise excluded peril. In doing so, however, under the Court of Appeals' construction of the policy, the Allemands actually reduced the coverage available to them for the fire loss.

Under the efficient proximate cause rule, had the Allemands declined the optional coverage, the entire loss would have been covered. Since the fire was the efficient proximate cause that triggered the excluded risk (building code enforcement), the excluded risk would not have defeated coverage. *Vil-
lolla*, 106 Wn.2d at 815. Simply put, State Farm's building ordinance or law exclusion contained in the loss settlement provisions applicable to Coverage A (which concurrently informs the insureds that they can avoid the exclusion

by paying extra for the optional building code enforcement coverage) circumvents the efficient proximate cause rule.

The Court of Appeals found that “Coverage A of the policy expressly indicates that it does cover building code upgrades caused by the same loss only under the optional OL coverage² and to the extent provided in that coverage [10% of the Coverage A limit].” Appendix A at 8-9. At footnote 2, the court stated, “This provision recognizes the efficient proximate cause rule . . . The policy actually applies the rule and covers building code upgrades that are required when repairing a covered loss.” Appendix A at 9.

The Allemands disagree with the Court of Appeals’ conclusion. The loss provisions applicable to Coverage A expressly *excluded* “increased costs resulting from [i.e., ‘caused by’] enforcement of any ordinance or law,” *unless* the Allemands paid an additional premium to purchase optional coverage for this exclusion. CP 23. There appears to be no case in this state addressing similar policy language. Construing this language, which is in effect a *conditional exclusion*, in light of the efficient proximate cause rule is critical in deciding this case.

If the Allemands declined to purchase the optional building code enforcement coverage under Option OL, then the building code enforcement exclusion would not apply at all to limit coverage for the fire loss. It would

be trumped by the efficient proximate cause rule, since the fire, a clearly covered peril, was the predominant cause of the loss. Thus, rather than recognizing and applying the efficient proximate cause rule, the Allemands' policy effectively does an end run around the rule.

4. As Construed by the Court of Appeals, the Optional Building Code Enforcement Coverage is Illusory Since, in Light of the Efficient Proximate Cause Rule, the Allemands Received No Benefit in Paying for This Additional Coverage; Thus, There Was No Consideration for Their Payment.

“[T]he court will not give effect to interpretations that would render contract obligations illusory.” *Taylor v. Shigaki*, 84 Wn. App. 723, 730, 930 P.2d 340 (1997), *review denied*, 132 Wn.2d 1009 (1997). “An illusory contract is unenforceable because there is no consideration.” *St. John Med. Ctr. v. Dep’t of Soc. & Health Servs.*, 110 Wn. App. 51, 68, 38 P.3d 383 (2002), *review denied*, 146 Wn.2d 1023 (2002). Where possible, a contract is to be construed to avoid rendering it illusory. *Taylor*, 84 Wn. App. at 730.

Here, the Court of Appeals' construction of the relevant policy language renders it illusory. The Allemands paid extra to purchase the optional building code enforcement coverage, but received less coverage for their additional payment. Again, had they not paid for the purported “additional coverage” offered by Option OL, their entire fire loss would have been covered under the efficient proximate cause rule. The appropriate way to reconcile

the policy language, so that it is not illusory, is to construe it so that the optional building code coverage applies only where the code upgrades themselves are the efficient proximate cause of the loss.

The relevant policy language states that State Farm “will not pay for increased costs *resulting from* enforcement of any ordinance or law.” CP 53 (italics added). The phrase costs “resulting from” is the functional equivalent of costs “caused by”. See *Webster’s New World Dictionary (2d College Ed.)*, defining the word “result” as “to happen or issue as a consequence or effect (often with *from*) [floods *resulting from* heavy rains].” (Italics original.) (See Appendix B.) Equating “resulting from” with “caused by” also comports with the layman’s understanding of these two phrases. “The language of insurance policies is to be interpreted in accordance with the way it would be understood by the average man, rather than in a technical sense.” *Dairyland Ins. Co. v. Ward*, 83 Wn.2d 353, 358, 517 P.2d 966 (1974).

“The *Graham* rule suggests that whenever the term ‘cause’ appears in an exclusionary clause it must be read as ‘efficient proximate cause.’ This interpretation is confirmed by *Villella*.” *Hirschmann*, 112 Wn.2d at 629. Restated accordingly, State Farm’s conditional building code exclusionary clause should be read this way: “We will not pay for increased costs where the *efficient proximate cause* of the loss is the enforcement of any ordinance

or law regulating the construction, repair or demolition of a building or other structure, except as provided under Option OL.” *Id.*

5. The Insurance Policy’s Language is Ambiguous.

“It is Hornbook law that where a clause in an insurance policy is ambiguous, the meaning and construction most favorable to the insured must be applied, even though the insurer may have intended another meaning.” *Dairyland*, 83 Wn.2d at 358. “A clause is ambiguous when, on its face, it is fairly susceptible to two different interpretations, both of which are reasonable.” *American Nat’l Fire v. B&L Trucking & Constr. Co.*, 134 Wn.2d 413, 428, 951 P.2d 250 (1998). Here, the policy informs the insured that building code enforcement costs are excluded from coverage, unless they purchase the optional coverage available for such costs under Option OL. CP 23. The opening paragraph of Option OL informs the insured that this optional coverage will provide them with *additional insurance* for the dwelling. CP 24. The language of the loss settlement provisions applicable to Coverage A also expressly refer to Option OL as “Building Ordinance or Law Coverage”. CP 23. Taken together, such language can be reasonably interpreted as informing the insured that Option OL provides separate, additional coverage for costs caused by the enforcement of building codes.

As understood by the average purchaser of insurance, a fair and rea-

sonable interpretation of the above policy language is that State Farm will pay up to the Option OL policy limit for the costs of the actual code upgrades themselves, *as additional insurance coverage* for the dwelling under Coverage A. However, it does not otherwise preclude the insured from receiving the full coverage available under Coverage A for damages to the dwelling that do not involve actual code upgrades, if the predominant cause of the damages is a covered peril.

Read this way, Coverage A provides a limit of \$89,866 for damages to the dwelling caused by a covered peril; whereas Option OL provides an additional \$8,986.60 of coverage to pay for the actual costs of the required code upgrades themselves. Option OL, however, does not otherwise limit or condition the insured's right to receive the full limit of Coverage A to rebuild or replace the dwelling when the loss is caused by a covered peril. This interpretation of the policy is consistent with the efficient proximate cause rule, as discussed in the previous section.

Under the Court of Appeals' interpretation of the policy, Option OL operates to reduce the amount of coverage otherwise available under Coverage A of the policy. The court's decision focused on Coverage A's language stating that State Farm would "repair or replace" the home with "similar construction". The court found that code upgrades do not involve "similar con-

struction”; therefore, “the Coverage A component of this policy does not include building code upgrades as the policy in *Starczewski* did.” See Appendix A at 8. This interpretation overlooks the fact that the Allemands had to tear down both the damaged and undamaged portions of their house. State Farm paid for only the estimated costs to repair the damaged portion of the house; it did not pay the Allemands anything for the undamaged portions that were razed, even though they could have been replaced with similar construction. The code upgrades included the foundation, crawl space, and electrical wiring, *not the entire house*. CP 27-28.

The Court of Appeals’ interpretation of the phrase “similar construction” actually supports the Allemands’ interpretation of the policy. Because code upgrades are in effect new improvements to the dwelling, they seldom involve “similar construction” to what existed prior to the dwelling sustaining damage or being destroyed, particularly with older dwellings like the Allemands’. This fact further supports interpreting the Allemands’ State Farm policy as limiting the increased costs caused by building code enforcement to the Option OL policy limit for the actual code upgrades themselves, not as a separate cap on the policy limit applicable to the dwelling under Coverage A of the policy.

Moreover, under State Farm’s all-risk “repair or replace” homeown-

ers' policy, the Allemands could reasonably expect that, for the total loss of their home, they would end up with a habitable dwelling, or at least the policy limit available for the dwelling under Coverage A. If State Farm wanted the coverage limit of Option OL to apply to reduce the amount available under Coverage A, when code upgrades are necessary, it could have worded the coverage language differently. "The [insurance] industry knows how to protect itself and it knows how to write exclusions and conditions." *Boeing v. Aetna Casualty & Surety Co.*, 113 Wn.2d 869, 887, 784 P.2d 507 (1990).

G. CONCLUSION

The efficient proximate cause of the Allemands' loss was an accidental fire, not the enforcement of any building ordinance or law. Had the Allemands not purchased the purported optional code enforcement coverage, their entire loss, up to the applicable policy limits, would have been covered. Unless the building ordinance or law exclusion applicable to Coverage A is construed to apply only when building code enforcement is the efficient proximate cause of the loss, the optional coverage under Option OL is illusory, since the insured pays an additional premium, but in fact receives less coverage under the circumstances as presented here. As construed by the Court of Appeals, the policy language also circumvents the efficient proximate cause rule. Accordingly, this Court should reverse the Court of Appeals' decision

and affirm the trial court's decision in favor of the Allemands.

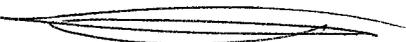
In doing so, the Court should find that exclusions, however worded, should not apply to trump the efficient proximate cause rule where the efficient proximate cause of a loss is an expressly covered peril. To hold otherwise defeats the purpose of the rule in multiple causation cases; it also leads to confusion and invites ongoing litigation as the lower courts struggle to construe insurance policy language in light of the rule. The purpose of the efficient proximate cause rule is to provide a workable rule of coverage that provides a fair result. If the efficient proximate cause of the loss is a covered peril, coverage should exist and the inquiry end at this point. Conversely, if the efficient proximate cause is an unambiguously excluded peril, coverage should not exist and the inquiry likewise end. This clear-cut application of the rule provides a workable, fair result.

DATED this 15th day of April, 2011.

Respectfully submitted,

CONE GILREATH LAW OFFICES

By:


Douglas W. Nicholson, WSBA #24854
Attorney for Petitioners

Appendix A

FACTS

Respondents Rex and Brenda Allemand owned a house in Kittitas that was severely damaged by fire on June 20, 2007. Repair costs were estimated at \$50,676.95. The house was built in 1940 and its foundation, crawlspace, and electrical wiring did not comply with modern building codes. Due to those deficiencies, the city would not issue permits for the repairs. Instead, the building had to be razed.

It cost the Allemands \$96,669.56 to replace the house under modern building requirements. Their State Farm homeowners' policy provided a maximum of \$89,866 under Coverage A to repair or replace the home "with similar construction." The policy also excluded "increased costs resulting from enforcement of any ordinance or law" including "construction repair or demolition" from coverage except as provided by optional Coverage OL. That optional coverage provided an additional sum, equal to 10 percent of the policy maximum, for costs resulting from building code enforcement. The Allemands had purchased Coverage OL.

State Farm paid the Allemands \$59,663.55, consisting of the estimated repair costs from the fire plus the maximum OL coverage for the code updates. The Allemands then

No. 28954-1-III
Allemand v. State Farm Ins. Cos.

filed an action for declaratory judgment and damages, arguing that State Farm was required to pay the maximum under both Coverage A and Coverage OL.¹

The trial court agreed, reasoning that the Coverage OL limits for building code upgrades did not limit the amount available under Coverage A. It awarded the Allemands an additional \$37,001 under the policy and directed State Farm to pay for their attorney fees as well. State Farm then timely appealed to this court.

ANALYSIS

The case turns on the meaning of the insurance policy. Well settled rules govern our review.

Interpretation of an insurance policy is a question of law reviewed *de novo*. *Woo v. Fireman's Fund Ins. Co.*, 161 Wn.2d 43, 52, 164 P.3d 454 (2007). Insurance policies are construed as contracts, so policy terms are interpreted according to basic contract principles. *Weyerhaeuser Co. v. Commercial Union Ins. Co.*, 142 Wn.2d 654, 665-666, 15 P.3d 115 (2000). The policy is considered as a whole, and is given a “fair, reasonable, and sensible construction as would be given to the contract by the average person purchasing insurance.” *Id.* at 666 (quoting *Am. Nat'l Fire Ins. Co. v. B&L Trucking & Constr. Co., Inc.*, 134 Wn.2d 413, 427, 951 P.2d 250 (1998)). If the language is clear, the court must enforce the policy as written and may not create

¹ The Allemands also alleged that they were underinsured. The trial court dismissed that claim with prejudice. The Allemands did not cross appeal the dismissal.

ambiguity where none exists. *Quadrant Corp. v. Am. States Ins. Co.*, 154 Wn.2d 165, 171, 110 P.3d 733 (2005). A clause is only considered ambiguous if it is susceptible to two or more reasonable interpretations. *Id.* If an ambiguity exists, the clause is construed in favor of the insured. *Id.* at 172. However, “the expectations of the insured cannot override the plain language of the contract.” *Id.*

The question of whether insurance coverage extends to costs necessary to bring a remodeled/rebuilt home into compliance with modern building codes has been discussed in a series of cases. Not surprisingly, the parties can each find some support for their position in existing case law.

The Allemands rely upon the earliest of the modern Washington cases, *Starzewski v. Unigard Insurance Group*, 61 Wn. App. 267, 810 P.2d 58, *review denied*, 117 Wn.2d 1017 (1991). There, Division One of this court heard several arguments from property owners whose duplex, a nonconforming property, had been severely damaged in a fire. *Id.* at 269. Their policy provided for loss payments up to the actual cash value of the property or “the amount necessary to repair or replace the damaged property.” *Id.* The owners raised a Consumer Protection Act claim (chapter 19.86 RCW) based, in part, on the insurance company’s refusal to include the costs of bringing the property into compliance with building codes as a component of repair costs. In rejecting one of the insurer’s counter arguments, the court held that the policy’s “repair or replace” language

No. 28954-1-III

Allemand v. State Farm Ins. Cos.

necessarily included compliance with the building codes. *Id.* at 274. It then ruled that the policy's exclusion for losses caused by compliance with laws was in conflict with the "repair or replace" language and was thus void. *Id.* The exclusion also conflicted with the efficient proximate cause rule under the facts of that case. *Id.*

Division One revisited the issue in *Roberts v. Allied Group Insurance Co.*, 79 Wn. App. 323, 901 P.2d 317 (1995). There a home had been destroyed by fire. The homeowner had a policy guaranteeing replacement cost "for like construction." *Id.* at 325. The policy defined replacement cost as repairing or replacing the damaged property "with new materials of like kind and quality." *Id.* at 325. The court distinguished *Starczewski* on the basis that its policy had not been limited to the "like kind" of repair. *Id.* Building code compliance was not included in the definition of "like kind." *Id.* (citing *Gouin v. Nw. Nat'l Ins. Co. of Milwaukee*, 145 Wash. 199, 259 P. 387 (1927)).

Gouin involved a house damaged by fire in Seattle. *Id.* at 200. The owner's insurance covered replacement or repair "of like kind or quality." *Id.* Modern building codes required the house to have a cement or stone foundation and required plaster walls; the previous house had no foundation and had cloth walls. *Id.* at 205. The property owner appealed a jury verdict upholding an appraisal panel's award. *Id.* at 204. Among the issues raised by the owner was a contention that the verdict was insufficient because the award did not include the cost to bring the repaired building up to code. *Id.* at 208.

No. 28954-1-III

Allemand v. State Farm Ins. Cos.

The Washington Supreme Court declared that such costs were not contemplated by the parties and the damages were limited to the actual cash value of the property or the cost to repair or replace with “material of like kind.” *Id.* at 208-209. In such circumstances, the building code requirements were not covered:

The requirements of the city went far beyond this. They required the foundations of the building to be entirely reconstructed and of different materials from that originally used; they required the upper parts of the building to be finished in a different manner than that in which it was originally finished; in fine, they required a practically new and more costly building. This, we cannot conclude, was with the contemplation of the contract.

Id. at 209.

In light of *Gouin*, the *Roberts* court summarily rejected the homeowner’s attempt to apply *Starczewski* to the “like construction” language used in that policy. 79 Wn. App. at 325. Instead, the court characterized the *Starczewski* discussion as *dicta* and noted that case had declined to follow contrary authority because its policy lacked the “like kind and quality” language found in the earlier cases. *Id.*

Division Two of this court likewise refused to apply *Starczewski* in *Dombrosky v. Farmers Insurance Co. of Washington*, 84 Wn. App. 245, 928 P.2d 1127 (1996), *review denied*, 131 Wn.2d 1018 (1997). There the policy had defined replacement cost in terms of “equivalent construction” and had excluded any costs related to enforcement of ordinances to repair or reconstruct the property. *Id.* at 257. The homeowners contended

that *Starczewski* had compelled coverage for costs increased by building code compliance. *Id.* at 258. The *Dombrosky* court again characterized the *Starczewski* discussion as *dicta* and instead chose to follow *Roberts*. *Id.* The court concluded that “equivalent construction” had the same effect as “like kind and quality.” *Id.* at 259.

This division visited the issue in *DePhelps v. Safeco Insurance Co. of America*, 116 Wn. App. 441, 65 P.3d 1234 (2003). There the homeowners’ policy also defined replacement cost in terms of “equivalent construction,” and the insurance company argued that *Roberts* and *Dombrosky* meant that it was not required to cover costs associated with code upgrades. *Id.* at 449. However, the policy also indicated that damages would be settled “on the basis of any ordinance or law that regulates the construction, repair or demolition of this property.” *Id.* This court had no difficulty distinguishing the earlier cases and concluding that this provision “expressly covers the cost of compliance with ordinances and building laws.” *Id.*

The parties understandably draw their battle lines among the modern foursome of cases, with the Allemands using *Starczewski* and *DePhelps*, while State Farm relies upon *Roberts* and *Dombrosky*. As all of those cases show, the ultimate controlling language is that found in the policy. The Coverage A language states in part that

- a. We will pay the cost to repair or replace with similar construction and for the same use on the premises . . . subject to the following:

....

- (4) we will not pay for increased costs resulting from enforcement of any ordinance or law regulating the construction, repair or demolition of a building or other structure, except as provided under Option OL – Building Ordinance or Law Coverage.

Clerk's Papers (CP) at 23.

The Option OL coverage provides in part:

1. **Coverage Provided.**

The total limit of insurance provided by this Building Ordinance or Law provision will not exceed an amount equal to the Option OL percentage shown in the **Declarations** of the Coverage A limit shown in the **Declarations** at the time of the loss This is an additional amount of insurance and applies only to the dwelling.

2. **Damaged Portions of Dwelling.**

When the dwelling covered under **COVERAGE A – DWELLING** is damaged by a Loss Insured we will pay for the increased cost to repair or rebuild the physically damaged portion of the dwelling caused by the enforcement of a building, zoning or land use ordinance or law if the enforcement is directly caused by the same Loss Insured and the requirement is in effect at the time the Loss Insured occurs.

CP at 24.

The policy at issue here covers “similar construction” and is the same as the “like” construction at issue in *Gouin* and *Roberts* and the “equivalent” construction in *DePhelps* and *Dombrosky*. Thus, the Coverage A component of this policy does not include building code upgrades as the policy in *Starzewski* did. Instead, Coverage A of the

policy expressly indicates that it does cover building code upgrades caused by the same loss only under the optional OL coverage² and to the extent provided in that coverage. That makes this case somewhat closer factually to *DePhelps* in that there is explicit coverage for code upgrades. Unlike that case, however, the policy here expressly limits the code upgrade coverage to 10 percent of the policy maximum.

In light of the foregoing authority, the policy language is clear and this court is not in a position to find it ambiguous. *Quadrant Corp.*, 154 Wn.2d 165. State Farm's original obligation under Coverage A is to provide "similar construction" in rebuilding the home. Unlike *Starczeweki*, that phrase does not include paying for required code upgrades. Instead, the policy provides for necessary upgrades by Option OL. That coverage is the sole source of the obligation to pay for bringing the remodeled home up to code. But that coverage is limited to the 10 percent of Coverage A that the Allemands purchased. The necessary upgrades required more than that figure and State Farm thus properly tendered its limits under that coverage. It was not required to pay more for the upgrades.

The Allemands also argue that the Option OL coverage is ambiguous because it makes reference to the policy limits shown in the "Declarations," but the coverage limits

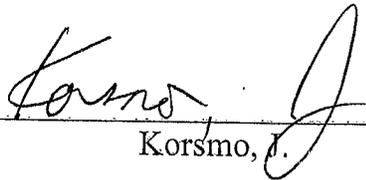
² This provision recognizes the efficient proximate cause rule; the Allemands' argument that the policy conflicts with that rule is without merit. The policy actually applies the rule and covers building code upgrades that are required when repairing a covered loss.

No. 28954-1-III

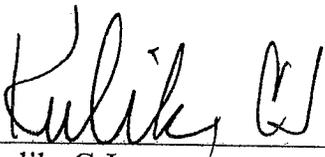
Allemand v. State Farm Ins. Cos.

page is not entitled “Declarations” nor is that word used on the page. Any confusion they may have had—and there has been no factual finding on that point—does not create an ambiguity. They were aware from Option OL that the coverage was limited. They were also aware from the cover page, even if they did not know what a “Declarations” was, what the limits were. Even if there was subjective confusion on this point, there was no ambiguity. The cover page, however denominated, expressly stated the limits of both Coverage A and Option OL. There was no ambiguity.

The judgment is reversed.


Korsmo, J.

WE CONCUR:


Kulik, C.J.


Siddoway, J.

Appendix B

SECOND COLLEGE EDITION

THE WORLD PUBLISHING COMPANY

Copyright 1938 and 1947 by

THE WORLD PUBLISHING COMPANY

WEBSTER'S
NEW WORLD
DICTIONARY

of the
American Language

David B. Guralnik, *Editor in Chief*

THE WORLD PUBLISHING COMPANY

New York and Cleveland

CERTIFICATE OF SERVICE

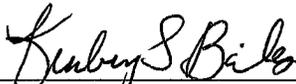
I certify that on the 1st day of April, 2011, I caused a true and correct copy of this Petition for Review to be served on the following in the manner indicated below:

Counsel for Respondents:

Steven M. Cronin
Mullin, Cronin, Casey & Blair, P.S.
Third Floor, Jockey Club Building
N. 115 Washington
Spokane WA 99201

(X) UPS Overnight
Delivery

By:



Kimberly Bailes