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No. 39625-8-III

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

TINA MACKAY

Petitioner,

VS.

PEMCO MUTUAL INSURANCE COMPANY,

Respondent.

#### **PETITION FOR REVIEW**

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Case #: 1034202

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#### I. INTRODUCTION

This case concerns the amount that Defendant PEMCO Mutual Insurance Company must pay to homeowners like Plaintiff Tina MacKay under the terms of PEMCO's homeowner's insurance policy (the Policy) for replacement of personal property. Ms. MacKay represents a certified class of homeowners insured by PEMCO. She understands the Policy to require PEMCO to pay insureds like her an initial Actual Cash Value (ACV) payment, which is calculated by determining the replacement cost of lost property (comprising the price of a new item plus sales tax) and then adjusting the price of the new item—but not the sales tax—to account for physical depreciation of the property. PEMCO counters that the Policy allows it to pay less than the full amount of sales tax in its initial ACV payment, thus requiring homeowners like MacKay to float the remaining amount of sales tax when they pay to replace the damaged property.

The ACV of MacKay's damaged property exceeded \$90,000. The cost to replace those items was even higher.

Because PEMCO refused to pay the full amount of sales tax in its ACV payment, MacKay could not afford to replace all her damaged property. The result is that PEMCO has retained the difference between its improperly discounted ACV payment and the full replacement cost of MacKay's property, creating a windfall of thousands of dollars for the insurer.

Yet in affirming the trial court's grant of summary judgment for PEMCO, the Court of Appeals concluded that it would be MacKay who would receive a windfall if PEMCO were required to pay her the full amount of sales tax in its ACV payment. This conclusion is contrary to this Court's reasoning in *Holden v. Farmers Insurance Co. of Washington*:

Regardless of whether the insured replaces the lost or damaged property, she paid sales tax when buying it originally. [The insured's] loss, for example, included the sales tax she paid when she bought the furniture and kitchen items. Furthermore, taking sales tax into account does not result in her reaping a windfall. Holden is not being paid an amount for sales tax she never incurred. Rather, the sales tax is simply included in calculating the replacement cost of the damaged property before subtracting for depreciation which is one way to estimate the property's current value.

169 Wn.2d 750, 759, 239 P.3d 344 (2010) (emphasis added).

The Court of Appeals further concluded that the Policy unambiguously requires only partial payment of sales tax in the ACV payment—even though the Policy does not mention sales tax or explain how sales tax is to be included in the ACV payment.

Discretionary review is necessary to address the conflict between the Court of Appeals' decision and this Court's reasoning in *Holden*, as well as the Court of Appeals' failure to address the decisions from courts in other states that read similar insurance policy provisions to forbid depreciation of sales tax. RAP 13.4(b)(1). The decision also impacts issues of

substantial public interest because thousands of

Washingtonians are affected by the question of how insurers

are to calculate the sales tax portion of ACV under policies

similar to the one at issue in this case. RAP 13.4(b)(4). For

these reasons, the Court should grant this petition and accept
review.

### II. IDENTITY OF PETITIONER

Petitioner Tina MacKay holds a PEMCO homeowner's insurance policy, under which she made timely claims after a fire damaged her home and personal property. She filed this action to recover the full amount of sales tax due under that policy on behalf of herself and a proposed class of insureds. MacKay respectfully asks this Court to grant her petition for review.

## III. CITATION TO THE COURT OF APPEALS DECISION

In *MacKay v. PEMCO Mutual Insurance Co.*, No. 39625-8-III, 2024 WL 3573842 (Wash. Ct. App., July 30, 2024), Division Ill of the Court of Appeals affirmed the trial court's summary judgment in favor of PEMCO, terminating review. That decision is attached in Appendix A ("the COA Opinion").

### IV. ISSUES PRESENTED FOR REVIEW

- 1) Does the Court of Appeals' decision that the Policy is not ambiguous as to the treatment of sales tax in PECMO's initial ACV payment conflict with this Court's decision in Holden v. Farmers Insurance Co. of Washington, 169 Wn.2d 750, 239 P.3d 344 (2010)? [Yes. Like the insurance policy in Holden, the Policy is ambiguous because it does not mention sales tax or explain how sales tax is to be included in payments to the insured.]
- 2) If so, is MacKay's interpretation of the Policy reasonable? [Yes. It is reasonable to interpret the Policy as requiring PEMCO to calculate the ACV payment by determining the replacement value of lost property, including price and

sales tax, and then reducing the price to account for physical depreciation of the property.]

#### V. STATEMENT OF THE CASE

A. The PEMCO Policy provides a two-step process for covered losses: an initial depreciated Actual Cash Value payment followed by a full Replacement Cost payment if the homeowner replaces the lost item.

PEMCO issues standardized homeowner insurance policies providing coverage for losses to dwellings and personal property from specified perils. CP 247-49. MacKay purchased her Policy from PECMO to cover her home in Cashmere, Washington. CP 115, 118. Coverage C of the Policy applies to personal property losses. CP 124.

Under Coverage C, "[c]overed property losses are settled" using "Replacement Cost," which the Policy defines as "the cost, at the time of loss, of a new article identical to the one damaged, destroyed or stolen." CP 123, 131. Where the replacement cost for the entire loss exceeds \$1,500, however,

PEMCO "will pay no more than the Actual Cash Value for the loss or damage until the actual repair or replacement is complete." CP 131. The Policy defines "Actual Cash Value" as "the market value of new, identical or nearly identical property less reasonable deduction for wear and tear, deterioration and obsolescence." CP 148.

PEMCO first makes an initial ACV payment to the insured based on its calculation of the property's "market value," less a deduction for depreciation. CP 148. Then, if the insured can afford to replace the property, PEMCO will reimburse the insured for the difference between the ACV payment and the actual replacement cost paid. CP 123. If the property is not replaced, no further payment is made.

When calculating the amount of the ACV payment for an item subject to sales tax, PEMCO determines the "market value" based on the prices of comparable replacements, then adds local sales tax to that purchase price, and finally

depreciates the entire amount by a percentage derived from a standardized depreciation table for personal property. CP 263-64.¹ The amount of the depreciation reflected in the depreciation table approximates how the property physically degrades over time. CP 273. "Each classification of personal property has its own useful life for purposes of depreciation.

Some types of property depreciate quickly, while others depreciate very little (if at all)." CP 261. To calculate ACV payments at scale, PEMCO uses software that "automatically"

<sup>&</sup>lt;sup>1</sup> Mathematically, the payment made to the insured is the same whether PEMCO calculates the sales tax on the price of the replacement item and then depreciates the sum of the price and tax, or if it applies a partial sales tax based on the depreciated price term. The Court of Appeals erroneously concluded that this mathematical equivalence means the sales tax owed to MacKay has not been depreciated. COA Opinion at 14. Not so. While the *rate* of sales tax has not been depreciated, the *amount* of sales tax owed to MacKay has. Regardless of whether PEMCO depreciates the sum of replacement cost and sales tax or applies the sales tax to the depreciated replacement cost, PEMCO is reducing the amount of the sales tax portion of the replacement cost by the depreciation factor.

calculates the depreciation percentage" based on the depreciation schedule for the relevant classification of personal property. CP 263-64.

PEMCO concedes that depreciation "applies to the item itself" only, not sales tax. CP 274. Like labor costs or profit margins, sales tax is an intangible cost that does not "wear and tear, deteriorat[e] or [become] obsolet[e]." CP 123. Yet despite PEMCO's admission that depreciation does not apply to sales tax—and despite the fact that sales tax is an intangible cost that does not wear, tear, deteriorate, or become obsolete— PEMCO applies the depreciation percentage to both the price of the physical replacement of the item and the associated, intangible sales tax. In so doing, PEMCO deprives MacKay and other insureds of the full benefits of the coverage they paid for. And PEMCO wrongfully places the burden on the insured to float the withheld amount of sales tax when replacing a lost item.

B. Ms. MacKay brought suit challenging PEMCO's ACV depreciation of sales tax, and PEMCO moved for summary judgment of all claims.

Based on PEMCO's standard practice of withholding portions of sales tax from ACV payments, MacKay sued PEMCO on behalf of a class of insureds for breach of contract, violation of Washington's Insurance Fair Conduct Act, violation of the Consumer Protection Act, bad faith, unjust enrichment, and declaratory judgment. CP 369-85.

The trial court certified the class and appointed MacKay as class representative in November 2021. CP 386-391. Shortly after, PEMCO moved for summary judgment on all of the class's claims. CP 001-34. The trial court granted the motion, and MacKay timely appealed. CP 366-68, 358-60.

The Court of Appeals affirmed, and MacKay now petitions this court for review under RAP 13.4(b)(1) and (4).

#### VI. ARGUMENT AND GROUNDS FOR REVIEW

A. This Court should grant the petition for review because the Court of Appeals' decision conflicts with this Court's decision in *Holden*.

The Court of Appeals misapprehended and misapplied this Court's decision in *Holden*. The Court of Appeals' reasoning directly contradicts key aspects of the *Holden* decision, creating an untenable conflict with this Court's precedent. And the Court of Appeals misstated important aspects of *Holden*'s reasoning, which—unless corrected—will create confusion and inconsistency among Washington courts. This Court should grant review to address the conflict and prevent further confusion in this important area of Washington law.

- 1. The Court of Appeals' reasoning contradicts key aspects of the *Holden* decision.
  - a. In Holden, this Court explained that part of an insured's loss is the sales tax they paid to purchase the lost item.

Holden concerned an insured's challenge to her insurer's practice of excluding sales tax from its calculation of fair market value when the insured did not replace her lost property. Holden, 169 Wn.2d at 752. The question was whether the "fair market value" of a new item, used to determine the value of a lost item before depreciation, was "subject to a reasonable interpretation that accounts for sales tax." Id. This Court found that the undefined policy terms were ambiguous and so construed the provisions in favor of the insured. Id.

In reaching this conclusion, the Court explained why sales tax is properly included in an insurer's initial ACV payments. The Court recognized that an insured's "full loss . . . include[s] the sales tax [they] paid when [they] bought the property" covered by their insurance policy. Id. at 759. So "taking sales tax into account does not result in [an insured] reaping a windfall." Id. Instead, including the full sales tax in

the ACV payment does not result in the insured "being paid an amount for sales tax [they] never incurred." Id. "Rather, the sales tax is simply included in calculating the replacement cost of the damaged property . . . ." Id. Calculation of the sales tax component of the replacement cost occurs "before subtracting for depreciation." Id.

b. The Court of Appeals' reasoning conflicts with Holden.

Though *Holden* did not reach the question whether sales tax can be depreciated when an ACV definition provides for depreciation of the price of replacement property, it did set forth several propositions about sales tax that the Court of Appeals contradicted in reaching the result in this case.

First, the Court of Appeals held that "PEMCO is not indemnifying the insured against some amount of sales tax the insured paid at some time in the past." COA Opinion at 13.

That holding is squarely contradicted by *Holden*, where this

Court explained that the insured's "full loss . . . included the sales tax she paid when she bought the [damaged property]."

Holden, 169 Wn.2d at 759. This Court noted that "[t]he indemnity argument fails to recognize [the insured's] full loss and does not reflect how ACV coverage works." Id. The Court of Appeals directly contradicts Holden's explicit reasoning.

Second, the Court of Appeals held that public policy does not require reimbursement of full sales tax because such reimbursement assumes "that [the insured] paid sales tax when the item was purchased" and that this was too speculative to be considered in what an insurance policy should cover. COA Opinion at 12. In *Holden*, this Court expressed no such concern and explained that in these types of policies the insurer uses a theoretical construct of "fair market value" to evaluate the loss. *Holden* recognized that "sales tax is simply included in calculating the replacement cost of the damaged property" because of the purpose of that

theoretical measurement of loss. *Holden*, 169 Wn.2d at 759.

The Court of Appeals thus contradicts *Holden*'s implicit reasoning.<sup>2</sup>

Third, the Court of Appeals held that "Ms. MacKay would receive a financial windfall if PEMCO was required to pay MacKay sales tax calculated on the replacement cost of damaged property even if she chooses not to replace the damaged property." COA Opinion at 11. Again, the Court of Appeals' reasoning is squarely rejected by *Holden*, which explains that "taking sales tax into account [for the ACV payment] *does not result in [the insured] reaping a windfall*."

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<sup>&</sup>lt;sup>2</sup> The Court of Appeals' reasoning also contradicts PECMO's actual practices. PEMCO does not require insureds to prove the price they originally paid for lost property, or the sales tax applicable to that property at the time. Instead, PEMCO bases its assessment of ACV on the current "market value of new, identical or nearly identical" items and applies the current sales tax rate. Because PEMCO does not require insureds to show the price or amount of sales tax originally paid, the Court of Appeals' reasoning is inapposite.

Holden, 169 Wn.2d at 759 (emphasis added). That is because the insured "is not being paid for sales tax she never incurred."

Id. Thus, sales tax is properly "included in calculating the replacement cost of the damaged property before subtracting for depreciation" from that replacement cost. Id.

c. Under Holden, the Court of Appeals should have concluded that the Policy is ambiguous.

The Court of Appeals' reasoning is also inconsistent with Holden's broader ambiguity analysis. This inconsistency has the potential to produce confusion and uncertainty in subsequent cases. Had the Court of Appeals faithfully applied Holden's reasoning, it would have concluded that the Policy is ambiguous for two reasons.

(i) Like the policy in *Holden*, the Policy here is ambiguous because it does not explain how sales tax is included in initial ACV payments.

The *Holden* Court concluded that the policy at issue was ambiguous primarily because that policy did not mention sales

tax or explain how sales tax would be included in the ACV payment required by the policy. The *Holden* policy "define[d] ACV as 'the fair market value of the property at the time of loss,'" but it "d[id] not define FMV or . . . expressly state whether sales tax is accounted for in calculating ACV or FMV." *Holden*, 169 Wn.2d at 753-54 (citations to record omitted). This Court reasoned that "there is nothing intrinsic in the notion of FMV that necessarily includes or excludes sales tax." *Id.* at 758. Accordingly, the Court concluded that the *Holden* policy was "at least ambiguous in terms of whether the calculation of ACV will . . . include[] sales tax." *Id.* at 760.

The Policy at issue here is ambiguous for the same reason: it does not explain the role that sales tax plays in the calculation of ACV. PEMCO agrees that sales tax should be included in the ACV of damaged property, but the parties disagree about how that sales tax should be calculated. COA

Opinion at 7 (citing Resp't Br. at 23-24). The Policy does not specify; it is therefore ambiguous.

PEMCO agrees that the relevant definition of ACV in the Policy is as follows: "the market value of new, identical or nearly identical property less reasonable deduction for wear and tear, deterioration and obsolescence." CP at 123. Nowhere in this definition does the Policy explain how sales tax should be calculated for the purpose of the initial ACV payment. Thus, the Policy is "at least ambiguous" as to that question. *Holden*, 169 Wn.2d at 760.

Yet the Court of Appeals concluded that "the Policy is not ambiguous" even though "the Policy's definition of 'actual cash value' lacks any reference to sales tax." Thus, the Court of Appeals' decision contradicts this Court's approach to ambiguity in *Holden*.

(ii) Like the policy in *Holden*, the Policy here is ambiguous because it is susceptible to more than one reasonable interpretation.

The parties offer competing interpretations of the Policy as to the calculation of sales tax in the initial ACV payment. As Holden and myriad other cases recognize, a policy term "will be deemed ambiguous if it is susceptible to more than one reasonable interpretation." Holden, 169 Wn.2d at 756 (citing Kitsap County v. Allstate Ins. Co., 136 Wn.2d 567, 576, 964 P.2d 1173 (1998)). Because MacKay's interpretation is reasonable, the Policy is ambiguous and her interpretation prevails. See id. at 760 ("Given such ambiguity, [the insured's] reasonable interpretation of the policy must be accepted.").

PEMCO interprets ACV as a measure of how much it would cost to buy a used version of the lost property (including sales tax). Call it the "garage sale" interpretation. If a new couch cost \$100 and \$10 sales tax was paid, then using the

garage sale interpretation with a 50% depreciation rate, the ACV payment for a lost used couch would be \$55.

MacKay's interpretation—which is more consistent with Holden's teachings about the role of sales tax in these policies—is that ACV is designed to approximate the insured's loss by taking a theoretical measure of the cost paid in the past and making an adjustment for the physical degradation of the item. Call it the "accountant" interpretation. Under the Policy, the calculation of ACV starts with "the market value of new, identical or nearly identical property." CP 148. As Holden requires, that initial figure includes not just the price or value of the new item, but also the sales tax paid on it. Holden, 169 Wn.2d at 759. Accordingly, the "market value of new" figure has two components: the price (or value) of the item and the sales tax. To account for the fact that the insured has lost a used rather than new version of the item, the Policy does what an accountant would do and applies depreciation to the value

of the item—reducing that component of the "market value of new" measurement for "wear and tear, deterioration and obsolescence." CP 148.

Using the numbers from the prior example, in the accountant interpretation an insured's loss is the \$10 sales tax originally paid and the depreciated value of the couch (\$50), resulting in a measure of loss (and therefore an ACV payment) of \$60.

This interpretation is reasonable. *Holden* explains that an insured's loss "include[s] the sales tax she paid when she bought the furniture." *Holden*, 169 Wn.2d at 759. So while the value of the couch in our example has depreciated over time, the sales tax paid has not. For the same underlying reasons this Court articulated in *Holden*, MacKay's interpretation of how to calculate the sales tax component of ACV is reasonable. *See id.* at 756 (citation omitted).

The conclusion that MacKay's interpretation is reasonable is underscored by the fact that it is shared by courts in other states, which have recognized that sales tax is an intangible cost that should not be depreciated when calculating ACV payments. See, e.g., Johnson v. Hartford Cas. Ins. Co., No. 15-CV-04138-WHO, 2017 WL 2224828, at \*7 (N.D. Cal. May 22, 2017) (explaining that sales tax is "not subject to 'depreciation' or deduction" when calculating ACV); Dieudonne v. United Prop. & Cas. Ins. Co., No. CV 19-12476, 2021 WL 4476782, at \*5 (E.D. La. Sept. 30, 2021) (finding that because the policy failed to explain whether depreciation applies to labor and sales tax it was ambiguous on this issue, and this ambiguity must be resolved in the insureds' favor such that those intangible costs are not depreciated). The Court of Appeals did not address the reasoning of these persuasive authorities, much less their significance in the assessment of whether McKay's interpretation is at least reasonable.

d. The Court of Appeals' conclusion that the Policy is unambiguous rests on two additional flawed premises.

The Court of Appeals provided two further reasons for its conclusion that the Policy is unambiguous as to the calculation of sales tax in the initial ACV payment. Neither is sound.

First, the Court of Appeals concluded that PEMCO's interpretation of the Policy complies with *Holden* because it pays *some* amount of sales tax in its ACV payments. But *Holden* decided only that the fair market value of a new item includes its sales tax (in the absence of clear policy language taking one position or the other). *Id.* at 756 (citation omitted). The Court in *Holden* was not asked whether the sales tax portion can be depreciated. The Policy therefore remains ambiguous as to how sales tax should be calculated for purposes of the initial ACV payment.

Second, the Court of Appeals erroneously believed that PEMCO's uniform practice of including a partial amount of sales tax in the initial ACV payment renders the Policy unambiguous. See COA Opinion at 10-11. It is true that PEMCO pays a portion of the applicable sales tax in the ACV payment. But this practice is irrelevant to the issue in this case of whether the Policy requires PEMCO to pay the full amount of the applicable sales tax in the ACV payments. In Holden, the insurer sometimes paid sales tax and sometimes did not, which the Court found relevant to its conclusion about ambiguity. Holden, 169 Wn.2d at 756-57. PEMCO's practices have no relevance either way to the Policy interpretation question.

Because the Court of Appeals' decision conflicts with this Court's decision in *Holden*—and because the Court of Appeals' rationale for departing from *Holden* is flawed—this Court should grant the petition for review. RAP 13.4(b)(1).

# B. This Court should grant the petition for review because this case involves an issue of substantial public interest.

Whether Washingtonians can recover the full amount of sales tax owed under their insurance policies is an issue of substantial public interest that merits this Court's review. RAP 13.4(b)(4).

For over a century, American law has established that questions of insurance coverage present questions of public interest to be addressed by state law. See German Alliance Insurance Co. v. Lewis, 233 U.S. 389, 406, 34 S. Ct. 612, 58 L. Ed. 1011 (1914) (rejecting challenge to state regulation of fire insurance and holding "the business of insurance [is] so far affected with a public interest as to justify legislative regulation of its rates"). Courts have continually affirmed that their regulations of insurance present issues of public interest. See, e.g., Cooper Co. of Gainesville v. State, 187 Ga. 497, 1 S.E. 2d 436, 438 (1939) ("The business of insurance is one so

clothed with a public interest, affecting the community at large, so as to render it peculiarly subject to proper governmental regulation."); The Universe Life Insurance Co. v. Giles, 40 Tex. Sup. Ct. 810, 950 S.W. 2d 48, 53 (1997) ("[W]e have long-recognized that the insurance industry is peculiarly affected with a public interest.").

Likewise, the fair operation of insurance policies constitutes a vital public interest in Washington. "The legislature has declared that the 'business of insurance is one affected by the public interest." *Moeller v. Farmers Ins. Co. of Washington*, 173 Wn.2d 264, 272, 267 P.3d 998 (2011) (citing RCW 48.01.030). Washingtonians depend on the insurance policies they purchase to recover from unexpected emergencies. Washington's sales tax is significant, so whether an insured can recover the full amount of sales tax due under their insurance policy determines whether they fully recover from those emergencies. That is why MacKay and the class

have brought a claim under the Consumer Protection Act, ch. 19.86 RCW, which is designed to combat unfair business practices that adversely affect the public interest. *See*Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co., 105 Wn.2d 778, 780, 719 P.2d 531 (1986) (holding "public interest impact" is an essential element of a CPA claim).

By construing an ambiguous insurance policy in favor of the insurer over the reasonable interpretation of the insured, the Court of Appeals has upset the traditional balance that protects the public interest. *See* Shauhin Talesh, *Insurance Law as Public Interest Law*, 2 UC IRVINE L. REV. 985, 1005 (2012) ("When insurance by itself does not function to assist the public, state regulation attempts to equalize the power imbalance . . . by developing a regulatory framework that tries to protect the public."). MacKay, like other Washingtonians who purchased PEMCO policies, expects that she will be made financially whole in the event of a catastrophic loss. There are

serious consequences when insurers undermine those expectations.

When PEMCO refuses to pay the full amount of sales tax owed under the Policy, for example, insureds are forced to float the difference between the partial sales tax paid in the initial ACV payment and the full amount of sales tax paid on a replacement item. This can be an enormous burden, especially when the damaged property is worth tens of thousands of dollars. MacKay has been unable to replace much of her damaged property because she cannot afford to float the difference in sales tax for lost property exceeding \$90,000 in value. Other Washingtonians face the same financial hurdles. The consequence is that many insureds cannot replace all their damaged property, allowing the insurer to retain the difference between ACV and the full replacement cost. This windfall benefits insurers at the expense of the insured, which

contravenes the public's substantial interest in receiving the full value of their insurance coverage.

Washington's Insurance Commissioner recognized this important public interest in a similar context in promulgating a rule holding that labor costs cannot be depreciated as part of insurance payments because labor is an intangible cost that does not physically degrade over time:

Except for the intrinsic labor costs that are included in the cost of manufactured materials or goods, the expense of labor necessary to repair, rebuild, or replace covered property is not a component of physical depreciation and may not be subject to depreciation or betterment.

WAC 284-20-010(4). In its proposal for this new rule, the Insurance Commissioner noted that depreciating labor "floats a significant part of the labor repair to the consumer . . . unfairly shifting the burden to the consumer." CP 335.

The public policy considerations that justify WAC 284-20-010(4) apply equally to sales tax. Like labor, sales tax is an

intangible cost associated with the replacement of lost property that does not physically degrade, wear, tear, or become obsolete.

The Court of Appeals stated that "there is no relationship to be inferred between sales tax and labor with respect to depreciation." COA Opinion at 15. But the point is not that WAC 284-20-010(4) applies directly to sales tax.

Instead, the point is that the logic underlying that regulation applies equally to all intangible costs associated with the replacement of lost property, including sales tax.

The public interest is advanced by ensuring that

Washingtonians can recover the full amount they are owed

under their insurance policies, including the applicable sales

tax. Because the Court of Appeals decision creates an

unwarranted hurdle to that recovery, and because this issue is

one of substantial public interest, this Court should grant

review. RAP 13.4(b)(4).

#### VII. CONCLUSION

The Court of Appeals issued a decision that directly conflicts with this Court's precedent and implicates issues of substantial public interest. To correct the Court of Appeals' errors and prevent further confusion in this vital area of law, this Court should grant the petition for review.

#### **RAP 18.17 CERTIFICATION**

Petitioner's counsel certifies that this brief contains 4,757 words in compliance with RAP 18.17(b) and RAP 18.17(c)(10).

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## RESPECTFULLY SUBMITTED AND DATED this 29th day of August, 2024.

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#### **CERTIFICATE OF SERVICE**

I certify that on August 29, 2024, I caused a true and correct copies of the foregoing to be served on the following via the Court of Appeals Electronic Filing Notification System:

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DATED this 29th day of August, 2024.

By: <u>/s/ Beth E. Terrell, WSBA #26759</u>
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Appendix A

# FILED JULY 30, 2024 In the Office of the Clerk of Court WA State Court of Appeals Division III

### IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON DIVISION THREE

TINA MACKAY, a single woman,	)	
	)	No. 39625-8-III
Appellant,	)	
	)	
v.	)	
	)	
PEMCO MUTUAL INSURANCE	)	UNPUBLISHED OPINION
COMPANY, a Washington Insurance	)	
Company,	)	
	)	
Respondent.	)	

Cooney, J. — Shortly after purchasing a homeowner's insurance policy (Policy) from PEMCO Mutual Insurance Company (PEMCO), a fire ravaged Tina MacKay's home. Ms. MacKay made a claim under the Policy that was promptly accepted by PEMCO. A dispute then arose over how sales tax on Ms. MacKay's personal property was calculated. PEMCO used the actual cash value of the damaged property to calculate sales tax while Ms. MacKay asserted that sales tax ought to be calculated on the replacement cost.

Ms. MacKay filed suit against PEMCO asserting claims for breach of contract, violation of Washington's Insurance Fair Conduct Act, ch. 48.30.010-.015 RCW, violation of the Consumer Protection Act, ch. 19.86 RCW, bad faith, unjust enrichment,

and declaratory judgment. Thereafter, PEMCO filed a motion for summary judgment, seeking dismissal of Ms. MacKay's claims. The trial court granted PEMCO's motion.

On appeal, we are presented with three questions. First, because the Policy does not define sales tax or explain how sales tax is treated for depreciation purposes, is the Policy's definition of "actual cash value" ambiguous? Secondly, can the Policy be reasonably interpreted to include sales tax on the replacement cost of damaged property when reimbursing the actual cash value of that property? Thirdly, does a Washington State insurance commissioner rule that prohibits the depreciation of the expense of labor impliedly preclude the depreciation of sales tax?

We conclude the Policy's definition of "actual cash value" is not susceptible to more than one reasonable interpretation, that the Policy cannot reasonably be interpreted to include sales tax on the replacement cost of damaged property when calculating the actual cash value, and decline to apply the insurance commissioner's rule prohibiting the depreciation of the expense of labor. Accordingly, we affirm the trial court's order on summary judgment.

#### BACKGROUND

In June 2017, Ms. MacKay purchased a homeowner's insurance policy from PEMCO. Under "Coverage C – Personal Property" of the Policy, Ms. MacKay was

No. 39625-8-III MacKay v. Pemco Mut. Ins. Co.

allowed to recover the replacement cost for any property loss up to \$174,300. Clerk's

Papers (CP) at 118, 131. In part, the Policy defined "replacement cost" as:

**b.** In case of loss to personal property, **replacement cost** means the cost, at the time of loss, of a new article identical to the one damaged, destroyed or stolen. When the identical article is no longer manufactured or available, **replacement cost** means the cost of a new article similar to the one damaged or destroyed and which is of comparable quality and usefulness, without deduction for depreciation.

CP at 123-24.

Later, the Policy was modified by Homeowners Amendatory Endorsement PM 49. Under Endorsement PM 49, coverage C was amended to include the following provision:

3. d. When the replacement cost of the entire loss is more than \$1,500, [PEMCO] will pay no more than the actual cash value for the loss or damage until the actual repair or replacement is complete, and then no more than the amount actually and necessarily spent to repair or replace.

CP at 145. The Policy defined "actual cash value" as:

#### 1. Actual Cash Value means:

- **b.** When the loss or damage to the property creates a total loss, **actual cash value** means the market value of property in a used condition equal to that of the destroyed property, if reasonably available on the used market.
- **c.** Otherwise, **actual cash value** means the market value of new, identical or nearly identical property less reasonable deduction for wear and tear, deterioration and obsolescence.

CP at 123.

In the event an insured suffered loss or damage of their property, the Policy provided a two-step process for indemnification. First, for purposes of making an initial actual cash value payment to the insured, PEMCO calculated the actual cash value of the damaged property. The actual cash value was determined by assessing the market value of the property, less a deduction for depreciation, then applying the sales tax rate effective in the insured's zip code. Secondly, if the insured replaced the damaged property, PEMCO would reimburse the difference between the actual cash value of the damaged property and the replacement cost paid by the insured, including sales tax. If an insured chose against replacing a damaged item, the Policy provided that PEMCO would only reimburse the actual cash value of the property.

On April 15, 2018, a fire at Ms. MacKay's home damaged her personal property. Ms. MacKay promptly notified PEMCO of the loss. PEMCO determined the loss was covered by the Policy and issued Ms. MacKay a \$5,000 advanced actual cash value payment. Loree Eads, a content inventory specialist with PEMCO, began cataloging the damaged property. Ms. Eads' inventory list included, among other information, the actual cash value of the damaged property, the replacement value of the damaged property, and whether the damaged items were subject to sales tax. When Ms. MacKay replaced an item, Ms. Eads would determine the replacement payment due Ms. MacKay. The replacement payment was the difference between the actual cash value of the

damaged item and the cost Ms. MacKay actually paid for the new item, including sales tax on the purchase price.

In her first report, Ms. Eads estimated the replacement cost due Ms. MacKay was \$26,063.22. After applying the applicable sales tax of 8.2 percent, totaling \$2,137.18, Ms. Eads calculated a total replacement cost of \$28,200.40. To assess the actual cash value, Ms. Eads reduced the replacement cost by applying a depreciation to the damaged property. Ms. Eads calculated the actual cash value of the damaged property at \$18,948.18. Ms. Eads then added the applicable sales tax rate for a total estimated actual cash value of \$20,501.93.

PEMCO made an initial actual cash value payment to Ms. MacKay of \$15,501.93. This amount consisted of the actual cash value of the damaged property, \$20,501.93, less the \$5,000 advanced actual cash value payment. Ms. Eads identified other damaged property not included in the initial actual cash value report. This led to PEMCO issuing a second actual cash value payment to Ms. MacKay of \$50,976.18. In 2019, after additional damaged property was identified by Ms. Eads, a third actual cash value payment of \$19,074.62 was issued to Ms. MacKay.

On May 17, 2019, Ms. MacKay's home was restored, allowing for her return.

PEMCO paid Ms. MacKay \$11,774.15 to pack, clean, store, and deliver her personal property from her temporary place of residence to her home. Following these payments,

PEMCO attempted to contact Ms. MacKay to inquire whether she intended to submit additional claims under coverage C. PEMCO never received a response.

In June 2020, Ms. MacKay filed a lawsuit against PEMCO that alleged PEMCO improperly withheld a portion of sales tax due her by depreciating sales tax when calculating the actual cash value of damaged property. Ms. MacKay asserted claims of breach of contract, violation of Washington's Insurance Fair Conduct Act, chapter 48.30 RCW, violation of the Consumer Protection Act, chapter 19.86 RCW, bad faith, unjust enrichment, and declaratory judgment. Ms. MacKay moved to have the lawsuit certified as a class action and to be appointed as class representative pursuant to CR 23. In November 2021, the court granted the motion for class certification.

Following certification, PEMCO moved for summary judgment, seeking dismissal of all of Ms. MacKay's claims. By way of a letter decision, the trial court granted PEMCO's motion. On March 28, 2023, the trial court entered an order dismissing Ms. MacKay's claims.

Ms. MacKay timely appealed.

#### ANALYSIS

On appeal, Ms. MacKay contends the Policy's definition of "actual cash value" is ambiguous because it fails to prescribe how sales tax is calculated when assessing the actual cash value of damaged property. Ms. MacKay further asserts that *Holden v*.

Farmers Insurance Co. of Washington, 169 Wn.2d 750, 239 P.3d 344 (2010), prohibits the depreciation of sales tax. Lastly, Ms. MacKay argues that a recent Washington State insurance commissioner rule that prohibits the depreciation of the expense of labor in standard fire insurance policies infers the depreciation of sales tax should be prohibited as well.

We conclude the Policy's definition of "actual cash value" is not susceptible to more than one reasonable interpretation and is, therefore, not ambiguous, disagree with Ms. MacKay's interpretation of *Holden*, and decline to apply the Washington insurance commissioner's rule.

As a preliminary matter, PEMCO agrees that under the terms of the Policy Ms. MacKay is entitled to payment of sales tax on the actual cash value and the replacement cost of damaged property (provided the damaged property is replaced). Indeed, PEMCO advanced Ms. MacKay the actual cash value of her damaged property, including sales tax. Once Ms. MacKay replaced the damaged property, PEMCO then reimbursed the difference between the actual cash value and replacement cost, including the difference in sales tax. Consequently, the dispute is whether the Policy requires PEMCO to advance Ms. MacKay sales tax based on the replacement cost of damaged property prior to her replacement of the property.

We review orders on summary judgment de novo, engaging in the same inquiry as the trial court. *Keck v. Collins*, 184 Wn.2d 358, 370, 357 P.3d 1080 (2015). Summary judgment is appropriate only if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. *Id.* at 370; CR 56(c). The moving party bears the initial burden of establishing that there are no disputed issues of material fact. *Young v. Key Pharm., Inc.*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989). "A material fact is one upon which the outcome of the litigation depends in whole or in part." *Atherton Condo. Apt.-Owners Ass'nBd. of Dirs. v. Blume Dev. Co.*, 115 Wn.2d 506, 516, 799 P.2d 250 (1990).

When considering a motion for summary judgment, evidence is considered in a light most favorable to the nonmoving party. *Keck*, 184 Wn.2d at 370. If the moving party satisfies its burden, then the burden shifts to the nonmoving party to establish there is a genuine issue for the trier of fact. *Young*, 112 Wn.2d at 225-26. While questions of fact typically are left to the trial process, they may be treated as a matter of law if "reasonable minds could reach but one conclusion." *Hartley v. State*, 103 Wn.2d 768, 775, 698 P.2d 77 (1985).

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. Com. Union Ins. Co., 142 Wn.2d 654, 665-66, 15 P.3d 115 (2000). We consider the policy as a whole, we give it 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., 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 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 fairly 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. Undefined terms do not automatically create ambiguity. Int'l Marine Underwriters v. ABCD Marine, LLC, 179 Wn.2d 274, 284, 313 P.3d 395 (2013).

Whether the Policy is Ambiguous and can be Interpreted to Include Sales Tax on the Replacement Cost of Damaged Property When Reimbursing the Actual Cash Value

Ms. MacKay argues *Holden* prohibits an insurer from depreciating sales tax from the replacement cost of damaged property when calculating the actual cash value of the property. We disagree.

Albeit the Policy's definition of "actual cash value" lacks any reference to sales tax, in light of *Holden* the definition is not susceptible to more than one reasonable

interpretation. In *Holden*, our Supreme Court addressed whether sales tax should be included in the actual cash value<sup>1</sup> of damaged property when the insurance contract is silent on sales tax. The Supreme Court surmised the average insurance consumer would understand actual cash value to be the replacement cost, or what it would cost to replace an item in the market, less depreciation to reflect the age or wear and tear of the damaged property. 169 Wn.2d at 757. Furthermore, the court reasoned "[s]ales tax represents a portion of the actual out-of-pocket expense to the buyer and bears on the decision to buy." *Id.* at 758. Therefore, the court concluded that since Farmers would occasionally apply sales tax when calculating the replacement cost of damaged property, "actual cash value," as defined in the contract, was ambiguous and should be construed in favor of the insured to include sales tax. *Id.* at 760-61.

Here, although the Policy's definition of "actual cash value" lacks any reference to sales tax, PEMCO agrees that sales tax should be included in the actual cash value of damaged property. Resp't's Br. at 23-24. In light of the court's holding in *Holden* and

<sup>&</sup>lt;sup>1</sup> In *Holden*, the Farmers' contract defined "actual cash value" as "'fair market value' . . . at the time of loss." 169 Wn.2d at 753. While the Farmers' contract did not define fair market value, the court acknowledged in other contexts it recognized fair market value to be "the amount of money which a well informed buyer, willing but not obliged to buy the property, would pay, and which a well informed seller, willing but not obligated to sell it, would accept." *Id.* at 758.

PEMCO's practice of including sales tax in the actual cash value and in the replacement cost of damaged property, the Policy is not ambiguous.

However, differentiable to the issue in *Holden*, Ms. MacKay argues that she is entitled to sales tax calculated on the replacement cost of the damaged property regardless of whether she chooses to replace the property. Because the contract in *Holden* was interpreted to include sales tax in the fair market value of property at the time of loss, the Supreme Court did not consider the inclusion of sales tax a financial windfall to Holden. Rather, application of sales tax to the fair market value of damaged property returned the insured to the same financial position they enjoyed before suffering the loss.

Unlike *Holden*, here, Ms. MacKay would receive a financial windfall if PEMCO was required to pay Ms. MacKay sales tax calculated on the replacement cost of damaged property even if she chooses not to replace the damaged property. Consumers in Washington regularly purchase used items in the marketplace at varying discounts compared to new items, understanding they will pay sales tax on the used price of the item rather than the new price. This is because the amount of sales tax charged for each retail sale is a percentage of, and solely reliant on, the "[retail] selling price" of the item at the time of purchase. RCW 82.08.20(1). As this is the case, we fail to foresee that an insured would expect to receive payment for the sales tax associated with the replacement cost of an item when being indemnified for the actual cash value of that item.

Therefore, the Policy cannot be sensibly construed as bifurcating the actual cash value into the replacement cost of the property, and associated sales tax on the replacement cost, and then depreciating the replacement cost to its current value while maintaining the sales tax calculated on the replacement cost. If a consumer entered the marketplace to replace the damaged item with an item in the same or similar condition, the consumer would expect to pay the actual cash value for the item plus the associated sales tax. It is therefore reasonable, when indemnifying an insured for their loss, to calculate sales tax on the actual cash value of the used and depreciated property, not the value of the property when it was new.

Ms. MacKay argues that because the public policy behind insurance indemnity is to "return the insured to the same financial position he or she enjoyed before suffering a property loss," she should be reimbursed for the sales tax she paid when she originally purchased the property. *Holden*, 169 Wn.2d at 761. Ms. MacKay's argument is premised on the assumption that she paid sales tax when the item was purchased. Assuming Ms. MacKay paid sales tax at the time of purchase, sales tax rates vary over time and location. Any attempt to estimate the amount of sales tax Ms. MacKay may have paid when purchasing the now-damaged property would be grounded in assumptions and speculation.

#### DEPRECIATION OF SALES TAX

Ms. MacKay next claims that sales tax is not subject to depreciation. As an initial matter, the record fails to show that PEMCO depreciated sales tax. Rather, PEMCO depreciated the value of the damaged property and then applied the sales tax rate for Ms. MacKay's zip code.

Importantly, "depreciation" applies to a new market item comparable "less reasonable deduction for wear and tear, deterioration and obsolescence." CP at 123. Once a consumer purchases an item in the retail market and pays sales tax, the tax belongs to the taxing authority. The taxing authority can, over and over, *ad infinitum*, collect sales tax on the same item if it is sold at retail. However, the consumer may not recover the sales tax if later the consumer decides to sell or trade the item to recoup their money. Under the Policy, PEMCO is initially indemnifying the insured against the actual cash value of the property at the time of loss, including the associated sales tax. PEMCO is not indemnifying the insured against some amount of sales tax the insured paid at some time in the past.

Furthermore, when calculating the actual cash value of an item, the same value may be reached by either adding the replacement cost and associated sales tax before applying depreciation or by applying depreciation to the replacement cost and then adding sales tax. As recognized in *Holden*, "sales tax is simply included in calculating

is one way to estimate the property's current value." 169 Wn.2d at 759 (emphasis added). Therefore, characterizing the sales tax as having been "depreciated" in the context of calculating actual cash value is a mischaracterization. The sales tax rate is simply pegged to the cost of an item purchased in the retail marketplace.

WASHINGTON STATE INSURANCE COMMISSIONER'S RULE

Ms. MacKay contends that because the Washington Office of the Insurance Commissioner has ruled that depreciation of the expense of labor in standard fire insurance policies is not subject to depreciation, an inference can be made that depreciation of sales tax should be treated in kind. We disagree.

Chapter 284-20 WAC regulates insurance policies. WAC 284-20-010(4) provides, "the expense of labor necessary to repair, rebuild, or replace covered property is not a component of physical depreciation and may not be subject to depreciation or betterment." The Washington Office of the Insurance Commissioner's stated reason for prohibiting the depreciation of labor is that:

The practice of depreciating labor costs on insurance payments for property damage claims floats a significant part of the labor repair costs to the consumer and their repair contractor, unfairly shifting a burden to the consumer during the repair process and likely against the principle of indemnity.

CP at 335.

Sales tax is calculated as a percentage of the retail selling price of an item. RCW 82.08.20(1). Therefore, the assertion that sales tax cannot be depreciated mischaracterizes how sales tax is calculated. Labor, on the other hand, is not necessarily fixed in any manner to the retail price of an item. For example, it would be possible for a consumer to hire a contractor to build a shed utilizing either new or used materials. The new materials would presumably be more expensive than the used materials. The reduced price of used materials would result from factoring in some depreciation. The sales tax on the materials would be reflective of the respective retail purchase prices, new or used. Nevertheless, the labor cost would remain unaffected by the utilization of either new or used materials. Taking this scenario a step further, materials acquired for free would not include any sales tax while the labor to build the shed would remain the same. Thus, there is no relationship to be inferred between sales tax and labor with respect to depreciation.

Notably, if the Washington State insurance commissioner had concerns about sales tax being calculated on the actual cash value of an item posing a significant hardship on consumers, they could adopt regulations similar to those applicable to the expense of labor. The expense of labor, with respect to reconstruction after a loss, is a significant part of the cost of replacing an insured's property, whereas sales tax is not.

We refrain from applying to the facts before us the insurance commissioner's rule prohibiting the depreciation of the expense of labor.

#### CONCLUSION

We conclude the Policy's definition of "actual cash value" is not susceptible to more than one reasonable interpretation and cannot reasonably be interpreted to include sales tax on the replacement cost of damaged property when calculating the actual cash value. Further, we decline to apply the insurance commissioner's rule prohibiting the depreciation of the expense of labor. We affirm the trial court's order on summary judgment.

A majority of the panel has determined this opinion will not be printed in the Washington Appellate Reports, but it will be filed for public record pursuant to RCW 2.06.040.

Cooney, J.

WE CONCUR:

Pennell, J.

Staab, A.C.J

Appendix B

PDF RCW 19.86.020

#### Unfair competition, practices, declared unlawful.

Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.

[ 1961 c 216 s 2.]

#### **NOTES:**

Hearing instrument dispensing, advertising, etc.—Application: RCW 18.35.180.

Appendix C

PDF RCW 19.86.090

## Civil action for damages—Treble damages authorized—Action by governmental entities.

Any person who is injured in his or her business or property by a violation of RCW 19.86.020, 19.86.030, 19.86.040, 19.86.050, or 19.86.060, or any person so injured because he or she refuses to accede to a proposal for an arrangement which, if consummated, would be in violation of RCW 19.86.030, 19.86.040, 19.86.050, or 19.86.060, may bring a civil action in superior court to enjoin further violations, to recover the actual damages sustained by him or her, or both, together with the costs of the suit, including a reasonable attorney's fee. In addition, the court may, in its discretion, increase the award of damages up to an amount not to exceed three times the actual damages sustained: PROVIDED, That such increased damage award for violation of RCW 19.86.020 may not exceed twenty-five thousand dollars: PROVIDED FURTHER, That such person may bring a civil action in the district court to recover his or her actual damages, except for damages which exceed the amount specified in RCW 3.66.020, and the costs of the suit, including reasonable attorney's fees. The district court may, in its discretion, increase the award of damages to an amount not more than three times the actual damages sustained, but such increased damage award shall not exceed twenty-five thousand dollars. For the purpose of this section, "person" includes the counties, municipalities, and all political subdivisions of this state.

Whenever the state of Washington is injured, directly or indirectly, by reason of a violation of RCW 19.86.030, 19.86.040, 19.86.050, or 19.86.060, it may sue therefor in superior court to recover the actual damages sustained by it, whether direct or indirect, and to recover the costs of the suit including a reasonable attorney's fee.

[ 2009 c 371 s 1; 2007 c 66 s 2; 1987 c 202 s 187; 1983 c 288 s 3; 1970 ex.s. c 26 s 2; 1961 c 216 s 9.]

#### **NOTES:**

**Application—2009 c 371:** "This act applies to all causes of action that accrue on or after July 26, 2009." [ 2009 c 371 s 3.]

Effective date—2007 c 66: See note following RCW 19.86.080.

Intent—1987 c 202: See note following RCW 2.04.190.

Short title—Purposes—1983 c 288: "This act may be cited as the antitrust/consumer protection improvements act. Its purposes are to strengthen public and private enforcement of the unfair business practices-consumer protection act, chapter 19.86 RCW, and to repeal the unfair practices act, chapter 19.90 RCW, in order to eliminate a statute which is unnecessary in light of the provisions and remedies of chapter 19.86 RCW. In repealing chapter 19.90 RCW, it is the intent of the legislature that chapter 19.86 RCW should continue to provide appropriate remedies for predatory pricing and other pricing practices which constitute violations of federal antitrust law." [ 1983 c 288 s 1.]

Appendix D

PDF RCW 19.86.093

#### Civil action—Unfair or deceptive act or practice—Claim elements.

In a private action in which an unfair or deceptive act or practice is alleged under RCW **19.86.020**, a claimant may establish that the act or practice is injurious to the public interest because it:

- (1) Violates a statute that incorporates this chapter;
- (2) Violates a statute that contains a specific legislative declaration of public interest impact; or
- (3)(a) Injured other persons; (b) had the capacity to injure other persons; or (c) has the capacity to injure other persons.

[2009 c 371 s 2.]

#### **NOTES:**

Application—2009 c 371: See note following RCW 19.86.090.

Appendix E

PDF RC

**RCW 48.01.030** 

#### Public interest.

The business of insurance is one affected by the public interest, requiring that all persons be actuated by good faith, abstain from deception, and practice honesty and equity in all insurance matters. Upon the insurer, the insured, their providers, and their representatives rests the duty of preserving inviolate the integrity of insurance.

[ 1995 c 285 s 16; 1947 c 79 s .01.03; Rem. Supp. 1947 s 45.01.03.]

#### **NOTES:**

Effective date—1995 c 285: See RCW 48.30A.900.

#### TERRELL MARSHALL LAW GROUP PLLC

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