



## IF IT IS NOT CLEARLY EXCLUDED, IT MUST BE INCLUDED: "FAIR MARKET VALUE" INCLUDES UNPAID SALES TAX IN WASHINGTON STATE

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On September 9, 2010, the Washington Supreme Court once again proved it will go to great lengths to protect policyholders in disputes with their insurers. In *Holden v. Farmers Ins. Co. of Washington*, — P.3d — (Sept. 9, 2010), the court deemed ambiguous the actual cash value ("ACV") provision in a renters policy. The court concluded that because the definition of ACV "does not clearly exclude sales tax" then sales tax must be included in ACV calculations. In so doing, the court raised new questions about the insurance industry's common understanding of actual cash value and fair market value.

At issue in *Holden* is the interpretation of specific policy language appearing in a "Broad Form Renters Package Policy" purchased by Laura Holden from Farmers Insurance Company of Washington. The policy's personal property coverage contained the following loss settlement provision:

Covered loss to property will be settled at actual cash value. Payments will not exceed the amount necessary to repair or replace damaged property, or the limit of insurance applying to property, whichever is less.

The policy defined ACV as "the fair market value of the property at the time of the loss." The policy contained no subsequent definition of fair market value ("FMV") or a description as to how Farmers would calculate FMV. The policy's "Contents Replacement Costs Coverage" provided the option of either a lump sum FMV payment upfront, or reimbursement of the actual amount spent to replace the property. According to the supreme court's opinion, Farmers admitted in discovery that it used multiple methods to determine fair market value and, in some cases, included sales tax in its ACV payments.

A fire in the kitchen of Holden's home damaged some of her personal property. She submitted a claim to Farmers, asking for a lump sum FMV payment upfront. In response, Farmers sent her a check for the FMV of the damaged property. This sum did not include Washington state sales tax. Holden asked Farmers to increase the amount to account for sales tax that she would have been required to pay if she had actually replaced the property. Farmers declined to do so, though it acknowledged if she purchased the items and paid sales tax, then

her reimbursement amount would include the sales tax she paid. Holden filed a putative class action lawsuit against Farmers, seeking payment of Washington state sales tax to all Farmers' policyholders who received payment for contents claims that did not account for unpaid sales tax.

In a 6-3 split decision, the Washington Supreme Court addressed the narrow issue of whether sales tax must be included in the calculation of ACV under the Farmers policy. The supreme court deemed the ACV provision ambiguous because 1) the policy did not "clearly exclude" sales tax, and 2) Farmers sometimes accounted for sales tax when calculating FMV. Despite the fact that the ACV provision was mandated by the insurance commissioner and not drafted by Farmers, the supreme court construed the ambiguity against Farmers. The supreme court therefore concluded that "the Policy must be read to include consideration of Washington state sales tax" regardless of whether the policyholder actually paid any sales tax.

Although the *Holden* analysis is narrowly tailored to the specific language in the Farmers renters policy, this decision nonetheless has legal implications for insurers handling first-party claims in Washington state in that it will likely encourage expansive policyholder arguments on issues such as:

- whether sales tax that is not "clearly excluded" in a policy must necessarily be included in all calculations of ACV;
- whether inconsistent application of policy language during the claims process supports an argument that policy language itself may be ambiguous; and
- whether policy language approved (or arguably mandated) by a state insurance commissioner that is deemed ambiguous is appropriately construed against insurers.

*Cozen O'Connor is a global leader in representing the insurance industry in coverage matters. To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact Melissa O'Loughlin White ([mwhite@cozen.com](mailto:mwhite@cozen.com), 206-373-7240) or Kevin A. Michael ([kmichael@cozen.com](mailto:kmichael@cozen.com), 206-373-7244).*