

Ambiguity Found by Washington Supreme Court in ACV Settlement Provision

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On September 9, 2010, the Washington Supreme Court held that an insured was entitled to recover sales tax under an actual cash value (“ACV”) loss settlement provision in her renter's insurance policy because of ambiguity regarding whether ACV includes sales tax.¹

The claim arose out of a fire to Laura Holden’s apartment, which damaged her personal property. Ms. Holden’s policy provided for settlement at ACV, but included an endorsement that would have allowed her to recover at replacement cost if she replaced the property within 180 days of the loss. Ms. Holden elected not to replace the damaged property. Farmers Insurance Company paid Ms. Holden \$1,174, based upon the fair market value (“FMV”) of her loss. The loss payment, however, did not include sales tax. Ms. Holden argued that the ACV payment should have included an adjustment based upon sales tax even though she did not replace the damaged property.

In its 6 to 3 decision, the Washington Supreme Court held that the following provision was ambiguous regarding whether Ms Holden was entitled to recover sales tax:

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

The policy defined ACV as FMV but did not define FMV. Our state Supreme Court acknowledged that in another (non-insurance) context FMV “is 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.” However, the court held this definition of FMV did not resolve the sales tax issue and that there is nothing intrinsic in the notion of FMV that necessarily includes or excludes sales tax.

In construing the loss settlement provision, the court considered evidence regarding Farmers claims handling practices in unrelated claims including that Farmers sometimes determined ACV by applying depreciation to replacement cost value, and sometimes included sales tax in its determination of replacement cost.

The court noted that the policy’s loss settlement provision does not clearly exclude or include sales tax and does not define FMV. The fact that the loss settlement provision references replacement cost, combined with the carrier’s claims handling practices, and the lack of a definition of FMV, according to the majority, created an ambiguity, which must be resolved in favor of the insured.

¹ *Holden v. Farmers Ins. Co.*, __ Wn.2d __, __ P.3d __, 2010 WL 3504821, (2010).

Practical Pointers:

- Review the language of the policy's loss settlement provision and any applicable endorsements when determining how to apply depreciation to a specific claim.
- Consistency in claims handling is important, so a claims handler should know and understand the insurance company's claims handling guidelines and/or "best practices" with regard to depreciation.
- Good claim file documentation is especially important whenever an exception to normal claims handling practice is made as an accommodation to an insured. The reason for any extension of coverage beyond what is required under the policy should be clearly explained in the claim file.
- In Washington, unless a policy's loss settlement provision unambiguously provides otherwise, the most conservative approach would be to use the following formula:

$$\text{ACV} = \text{RCV} + \text{Washington Sales Tax} - \text{Depreciation.}$$

** If you have any questions concerning this article or would like copies of the decision, please contact Paul M. Rosner, J. D., PCU of Soha & Lang P. S. at (206) 654-6601. Soha & Lang, P.S. is regional and national coverage counsel for a number of the nation's major insurance companies. Advising and representing insurers in the resolution of coverage and bad faith disputes is the major focus of the firm's practice. The views expressed in this article are those of the author and do not necessarily reflect the opinions of the firm or its clients.*