

**IN THE SUPREME COURT OF THE STATE OF WASHINGTON**

laura holden,

Petitioner,

v.

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

Respondents.

NO. 81487-2

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Filed September 9, 2010

Stephens, J.—Laura Holden purchased a renter’s insurance policy from Farmers Insurance Company of Washington (Farmers). In the event of property loss due to fire, the policy provides coverage for the “actual cash value” (ACV) of the damaged property. ACV is defined as “fair market value” (FMV) at the time of loss. FMV is not defined. After a fire at her rented home damaged some of her personal property, Holden sought coverage under the ACV provision, which states

that payments will not exceed the lesser of either policy limits or “the amount necessary to repair or replace the damaged property.” Clerk’s Papers (CP) at 99. Farmers refused to account for Washington State sales tax when calculating the value of the damaged property. We are asked to decide whether, under the terms of this policy, the ACV provision unambiguously supports Farmers’ interpretation, or if instead it is subject to a reasonable interpretation that accounts for sales tax in calculating the FMV of damaged property. Because the ACV provision is ambiguous and accordingly must be construed in favor of the policyholder, we reverse the Court of Appeals and reinstate the trial court’s order granting Holden’s motion for summary judgment.

#### FACTUAL & PROCEDURAL HISTORY

On June 9, 2004, a fire broke out in the kitchen of the rented house at which Holden and her three children lived. The fire damaged or destroyed some of the family’s personal property, including furniture and various kitchen items. At the time of the fire, Farmers insured Holden under a “Broad Form Renters Package Policy” (Policy), which included coverage for fire damage. CP at 91. The Policy contains the following provision on loss settlement:

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.

CP at 99. The Policy defines ACV as “the fair market value of the property at the time of loss.” *Id.* at 93. The Policy does not define FMV or specify what method Farmers will use to calculate ACV or FMV. Nor does the Policy expressly state

whether sales tax is accounted for in calculating ACV or FMV.

For an extra premium, Holden also purchased a “Contents Replacement Cost Coverage” endorsement (RCE) with her Policy. CP at 118. The RCE provides for “the full cost of repair or replacement without deduction for depreciation.” *Id.* “Replacement cost” is defined as “the cost, at the time of loss, of a new article identical to the one damaged, destroyed or stolen.” *Id.* The RCE provision requires the insured to actually replace or repair the damaged property within 180 days of the loss. The insured pays the cost of repair or replacement out-of-pocket and submits receipts to Farmers for reimbursement under the RCE. Farmers often pays sales tax under the RCE, upon proof that it has been incurred.

After the fire, Holden submitted a claim to Farmers under the ACV provision of the Policy. Farmers sent Holden a check for \$1,174.41, an amount Farmers determined to be the FMV of Holden’s property. This amount was calculated with no regard to Washington state sales tax. When Holden requested that sales tax be included in calculating her reimbursement, Farmers informed Holden that if she submitted receipts for coverage under the RCE, only then would her reimbursement include sales tax. Holden explained in her deposition that she opted not to submit her claims under the RCE because she could not afford to pay the out-of-pocket repair or replacement cost and wait for reimbursement from Farmers. *Id.* at 61, 82.

Holden brought a putative class action against Farmers, seeking a declaration that sales tax should be accounted for in the ACV calculation for her claim and requesting relief for all similarly situated insureds. During discovery, Farmers

disclosed that it uses a variety of methods to calculate FMV under the ACV provision, including surveying online markets, hiring an appraiser, and using a replacement-cost-less-depreciation formula. Farmers acknowledged that when it uses replacement cost less depreciation to calculate FMV, replacement cost sometimes includes sales tax. Under the ACV provision, Farmers includes sales tax in replacement cost when the policyholder replaces the damaged property.<sup>1</sup> CP at 142; Report of Proceedings at 75-76, 78.

After discovery, Farmers and Holden filed cross motions for summary judgment. The superior court granted Holden's motion and denied Farmers' motion. The court reasoned that because Farmers uses various methods to determine FMV under the ACV provision, the definition of FMV is subject to more than one reasonable interpretation, thereby making the term ambiguous. As a result, the trial court ruled that the ambiguity must be construed in favor of the insured with sales tax being part of FMV for purposes of Farmers' policy.

The superior court certified the summary judgment order for immediate appeal pursuant to RAP 2.3(b)(4). Farmers filed a motion for discretionary review, which Division One of the Court of Appeals granted. The Court of Appeals then reversed, holding that coverage under the ACV provision does not include sales tax because replacement cost considerations apply only when the property is actually

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<sup>1</sup> Farmers may also include sales tax in calculating loss under the ACV provision when the homeowner does not replace the property but the amount of depreciation is small. For example, if a policyholder bought a toaster for \$30 plus sales tax, and the toaster were destroyed the next day, Farmers admits that the ACV of the toaster would be \$30 plus tax. This is because Farmers would include sales tax in the replacement cost, and then subtract zero depreciation for the one day the toaster was owned. CP 140-41.

replaced. *Holden v. Farmers Ins. Co. of Wash.*, 142 Wn. App. 745, 752, 175 P.3d 601 (2008). Holden filed a petition for review, which we granted. *Holden v. Farmers Ins. Co. of Wash.*, 164 Wn.2d 1025, 195 P.3d 957 (2008).

#### ANALYSIS

Interpretation of an insurance contract is a question of law reviewed de novo. *NH Indem. Co., Inc. v. Budget Rent-A-Car Sys., Inc.*, 148 Wn.2d 929, 933, 64 P.3d 1239 (2003). We look to the whole contract, giving it a “fair, reasonable, and sensible construction.” *Am. Nat’l Fire Ins. Co. v. B&L Trucking & Constr. Co.*, 134 Wn.2d 413, 427, 951 P.2d 250 (1998) (quoting *Key Tronic Corp. v. Aetna (CIGNA) Fire Underwriters Ins. Co.*, 124 Wn.2d 618, 627, 881 P.2d 201 (1994)). We give the language of the insurance policy the same construction that an “average person purchasing insurance” would give the contract. *Woo v. Fireman’s Fund Ins. Co.*, 161 Wn.2d 43, 52, 164 P.3d 454 (2007) (quoting *Roller v. Stonewall Ins. Co.*, 115 Wn.2d 679, 682, 801 P.2d 207 (1990)).

When, as here, a policy term is undefined, it must be given its “plain, ordinary, and popular” meaning. *Kitsap County v. Allstate Ins. Co.* 136 Wn.2d 567, 576, 964 P.2d 1173 (1998) (quoting *Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 877, 784 P.2d 507 (1990)). A term will be deemed ambiguous if it is susceptible to more than one reasonable interpretation. *Id.* To help resolve ambiguity, we may look to context and the intent of parties. *Quadrant Corp. v. Am. States Ins. Co.*, 154 Wn.2d 165, 171-72, 110 P.3d 733 (2005). Any remaining ambiguity must be construed against the insurer and in favor of the insured. *Id.* at

173.<sup>2</sup>

The ACV coverage at issue provides for the settlement of losses according to the FMV of the damaged property. Farmers advances a technical definition of FMV, but it is the ordinary understanding of the contract that controls. A technical approach fails to account for the way Farmers actually implements the ACV coverage provision. One method Farmers uses to calculate FMV looks at current replacement cost less depreciation. Farmers admits that it sometimes calculates replacement cost to include sales tax, representing the amount of money a buyer would actually have to spend to replace the damaged property. The language of the ACV provision plainly allows for looking at replacement cost in calculating the insured's loss:

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.

CP at 99 (emphasis added). This policy provision suggests to the average insurance consumer that his or her loss will be determined according to what it would cost to replace the property, less depreciation to reflect the age or wear and tear of the damaged property.<sup>3</sup>

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<sup>2</sup> This rule of construction is no less applicable for a policy provision approved or mandated by the insurance commissioner, as in a fire insurance policy. The particular policy language remains a matter of choice for the drafter, so long as it is “not less favorable to the insured than the ‘standard fire policy.’” WAC 284-20-010(3)(c). There is no support in our case law for Farmers’ proposition that the normal rules of construction do not apply when a policy provision is drafted by an insurer in conformance with applicable insurance regulations.

<sup>3</sup> The dissent insists that the policy does not say that ACV *equals* replacement cost, but merely that any payout will not *exceed* replacement cost. Dissent at 10-11.

Yet, Farmers argues and the dissent concludes that sales tax must be excluded from any replacement cost calculation on the ground that FMV, as used in other contexts, excludes consideration of taxes. *See* Farmers’ Suppl. Br. at 8-12; Dissent at 2-4. The dissent notes that inheritance tax and property tax are assessed on the FMV of taxable items before tax. If tax were included, the argument goes, an endless cycle would be created because one would need to know the tax in order to determine the FMV, in order to determine the tax, etc. The problem with this “chicken and egg” argument is that the meaning of FMV in other contexts is irrelevant. Its meaning in the context of this insurance contract is what matters, which is why Farmers’ own practice of including sales tax is critical. Indemnifying a policyholder for his or her actual loss is quite different from valuing property for the purpose of assessing an inheritance, property, or capital gains tax.

Nor does it advance the argument to say that the traditional notion of FMV necessarily excludes transaction costs, such as sales tax, because these extra costs do not add to the value of an object. Farmers’ policy does not define FMV in this manner. Indeed, it does not define the term at all. We have recognized in other contexts that the common understanding of “[f]air market value” is the amount of money which a well informed buyer, willing but not obliged to buy the property,

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True, but the reference to replacement cost in the ACV coverage provision undercuts the dissent’s view that no reasonable policyholder could believe that the sales tax incurred in replacing damaged property would be accounted for. The question is not whether ACV is defined as replacement cost, but rather what method or methods are allowed to calculate ACV. The policy does not specify a method. From its practice when settling other ACV claims, we know that Farmers reads the policy language to allow the inclusion of sales tax in the replacement-cost-less-depreciation method of determining FMV. It is not unreasonable for an insured to read the policy in the same way.

would pay, and which a well informed seller, willing but not obligated to sell it, would accept.”” *State v. Rowley*, 74 Wn.2d 328, 334, 444 P.2d 695 (1968) (quoting a jury instruction). Sales tax represents a portion of the actual out-of-pocket expense to the buyer and bears on the decision to buy. Accordingly, there is nothing intrinsic in the notion of FMV that necessarily includes or excludes sales tax.<sup>4</sup>

Faced with the fact that Farmers only sometimes interprets FMV to include sales tax—namely, when a policyholder replaces damaged property under the ACV provision—the Court of Appeals asserted that such practice reflects “a consistent application of the principles of indemnification.” *Holden*, 142 Wn. App. at 752. But, whether an ACV claimant actually replaces damaged property has no logical bearing on the property’s FMV. Consider an example in which two different policyholders own identical sofas that are destroyed in fires. Each seeks coverage under the ACV provision, so Farmers must determine the sofas’ ACVs. If one of the policyholders buys a new sofa, does this fact affect the value of the old sofa that was destroyed? Does it mean that this policyholder’s sofa was worth more than the identical sofa of the policyholder who did not buy a new one? Of course not; the value of the old sofas was the same without regard to these circumstances. The sole purpose in using a replacement-cost-minus-depreciation method of valuation is to

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<sup>4</sup> Indeed, the Washington State insurance commissioner issued a bulletin relating to sales tax and ACV claims, advising that sales tax must be dealt with by insurers “in good faith.” CP at 224 (Wash. Office of Ins. Comm’r, Bulletin No. 89-3 (Apr. 5, 1989)). The bulletin notes that in ACV claims, “the cost of repairing and restoring a building or other object to the condition it was in before the loss is not only material, but is the most persuasive evidence of the amount of loss for which the insurer is liable. Obviously, such costs will include sales tax.” *Id.*



estimate the policyholder's loss. This loss is the same regardless of whether the sofa is actually replaced.

Farmers argues that indemnity does not support including sales tax in the ACV calculation when an RCE-covered insured does not replace the property. *See* Farmers' Suppl. Br. at 14-15, 17. This argument insinuates that the same ACV language should be interpreted differently depending upon whether the policyholder also purchased RCE coverage. *Cf.* Dissent at 7-9 (interpreting Holden's ACV coverage differently because she also purchased RCE coverage). The indemnity argument fails to recognize Holden's full loss and does not reflect how ACV coverage works. Regardless of whether the insured replaces the lost or damaged property, she paid sales tax when buying it originally. Holden'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. Under Farmers' indemnity analysis, Holden is denied the full benefit of her ACV coverage because she purchased RCE coverage but did not use it.

There is no legal authority for interpreting a policy provision differently for different policyholders depending on what other coverage is purchased—especially when that other coverage is not at issue. The ACV provision, the only provision at

issue here, makes no distinction between the value of ACV coverage when a policyholder has the wherewithal to immediately replace all lost or damaged property versus when he or she must instead settle for the cash and replace what he or she can. Holden is entitled to the ACV of her damaged property whether or not she is able to use the insurance proceeds to repair or replace it. Focusing on the ACV provision, as we must, it is at least ambiguous in terms of whether the calculation of ACV will be based on a replacement cost formula that includes sales tax. Given such ambiguity, Holden's reasonable interpretation of the policy must be accepted.<sup>5</sup>

To the extent Farmers relies on precedent to argue that ACV cannot mean replacement cost (including sales tax) minus depreciation, it misconstrues our case law. Farmers cites *National Fire Insurance Co. v. Solomon*, 96 Wn.2d 763, 638 P.2d 1259 (1982), for the proposition that FMV cannot be calculated using the replacement-cost-less-depreciation method. As the Court of Appeals noted, however, neither *Solomon* nor our subsequent decision in *Hess v. North Pacific Insurance Co.*, 122 Wn.2d 180, 859 P.2d 586 (1993), controls the analysis here

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<sup>5</sup> The dissent incorrectly asserts that under Holden's reading of the policy, the ACV and RCE coverages would be redundant. Dissent at 9. Besides the differences between how the coverages operate, as identified in the main text, a principal benefit of the extra RCE coverage is that the loss is settled at replacement cost without regard to depreciation. In contrast, the FMV of damaged property under the ACV coverage is depreciated. This difference has nothing to do with the inclusion or exclusion of sales tax, which is not a unique benefit of RCE coverage. The record is clear that Farmers accounts for sales tax under both the ACV and RCE coverages in some instances. Although it refused to do so in Holden's case, as discussed above, the policy language does not unambiguously preclude accounting for sales tax in paying claims under the ACV coverage.

because those cases concerned the interpretation of a replacement cost coverage provision, not an ACV provision. *Holden*, 142 Wn. App. at 751. The Court of Appeals further noted that any commentary about ACV in those opinions was dictum and neither decision addressed the issue of sales tax. *Id.* We agree with the Court of Appeals that we are not bound by the discussion of ACV in either opinion.

Because the ACV provision in Farmers' policy is ambiguous, it must be read favorably to insureds to include consideration of Washington State sales tax in calculating the FMV of damaged property. This does not result in a "windfall" to an insured who does not immediately replace damaged property. Instead, it returns the insured to the same financial position he or she enjoyed before suffering a property loss.

#### CONCLUSION

The value of coverage under the ACV provision of Farmers' policy does not clearly exclude sales tax on damaged or destroyed property. While the policy defines ACV as FMV, it gives no definition of FMV. Neither does the traditional notion of FMV exclude sales tax from its definition. Farmers sometimes accounts for sales tax when calculating FMV. Moreover, the ACV provision indicates that the measure of recovery is related to "the amount necessary to repair or replace the damaged property." CP at 99. This language, combined with Farmers' practices and the absence of a definition for FMV, creates an ambiguity as to whether sales tax is included under the ACV provision of the Policy. Because we construe this ambiguity against Farmers, the Policy must be read to include consideration of

Washington State sales tax. We reverse the Court of Appeals and remand for further proceedings consistent with this opinion.

AUTHOR:

Justice Debra L. Stephens

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WE CONCUR:

Chief Justice Barbara A. Madsen

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Justice Charles W. Johnson

Justice Mary E. Fairhurst

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Justice Richard B. Sanders

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Justice Tom Chambers

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