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The Policyholder Law Firm



Precluding the Exclusion: Washington State's High Court Applies the Efficient Proximate Cause Rule in Liability Coverage Dispute

By Raymond A. Mascia Jr.

Under the “efficient proximate cause” rule, if the initial event causing a loss is a covered peril, an insurance policy must provide coverage even if a subsequent event in the chain, which also may have caused the loss, is excluded under the policy. In Washington, courts had only applied the efficient proximate cause rule in the first-party property context. However, the Washington Supreme Court recently affirmed that the rule applies equally in the third-party liability context, drastically narrowing the applicability of the pollution exclusion. The court further held that the insurance company acted in bad faith by failing to consider the efficient proximate cause rule when it denied coverage based on the pollution exclusion. The case is *Xia v. ProBuilders Specialty Insurance Co.* RRG, No. 92436-8, 2017 Wash. LEXIS 443 (Apr. 27, 2017).

The facts of *Xia* are straightforward. Shortly after moving into a new home, the claimant allegedly suffered personal injury due to a carbon monoxide leak, which was caused by the negligent installation of a hot water heater. The claimant sued the builder, which had a commercial general liability insurance policy. The insurance company refused to defend or indemnify the builder based in part on the insurance policy's pollution exclusion. The claimant and the builder settled, and the

builder assigned its coverage claims to the claimant. In the subsequent coverage litigation, the Washington Court of Appeals found that the insurance company was entitled to summary judgment based on the pollution exclusion. The claimant appealed to the Washington Supreme Court.

Washington State's highest court reversed. The court found that, even though the pollution exclusion applied to the facts, the insurance company owed a duty to defend nonetheless because the pollution — that is, the release of carbon monoxide — only occurred after an initial covered occurrence — that is, the “negligent installation” of a hot water heater. The court explained that under Washington law, insurance companies must apply the efficient proximate cause rule to determine whether coverage exists. The rule holds that “[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.” *Xia*, 2017 Wash. LEXIS 443, at *14 (internal quotation marks and citations omitted).

The court acknowledged that no Washington court had ever applied the efficient proximate cause rule outside of the first-party property context. However, the court explained

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that applying the rule in the third-party liability context was not a novel expansion of the law, as the courts had never before suggested that the rule was limited to specific insurance policies. Rather, the court explained that “[h]aving received valuable premiums for protection against harm caused by negligence, an insurer may not avoid liability merely because an excluded peril resulted from the initial covered peril.”

The court further held that the insurance company’s denial constituted bad faith as a matter of law. In so holding, the court noted that neither the insurance company nor its claims administrator “conducted any investigation into Washington law that might have alerted them to the rule of efficient proximate cause.”

The court’s holding in *Xia* dramatically narrows the applicability of standard form pollution exclusions, as well as other exclusions that purport to exclude events that occur only after a covered occurrence. In sum, policyholders should not accept denials of coverage where the facts demonstrate that their losses are initially caused by covered perils, notwithstanding policy provisions that purport to exclude coverage for subsequent events. ▲

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