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Precluding the exclusion: Washington state's high court applies the efficient proximate cause rule in liability coverage dispute

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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.

On April 27, 2017, however, the Washington Supreme Court issued an opinion holding that the efficient proximate cause rule applies equally in the third-party liability context. The court's ruling drastically narrows 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*, 188 Wn. 2d 171 (2017).

The facts of *Xia* are straightforward. Shortly after moving into a new home, the plaintiff claimed that she became sick and suffered personal injury due to a carbon monoxide leak, which was caused by the negligent installation of a hot water heater.

The plaintiff 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 plaintiff and the builder eventually settled, and the builder assigned its coverage claims to the plaintiff.

In the subsequent coverage litigation, the Washington Court of Appeals granted summary judgment to the insurance company based on the pollution exclusion. The plaintiff 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*, 188 Wn. 2d at 183 (internal quotation marks and citations omitted).

The court acknowledged that it had applied the efficient proximate cause rule only in first-party coverage cases.

However, the court explained that applying the rule in the third-party liability context was not a novel expansion of the law, as the court had "never before suggested that the rule ... is limited to any one particular type of insurance policy." *Id.*

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." *Id.*

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." *Id.* at 189.

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.

Shortly after the Supreme Court's decision, the insurance company filed a motion for reconsideration asking the court to reexamine its ruling.

On August 17, 2017, the court denied the motion, leaving in place a ruling that could benefit many policyholders. *See Xia v. ProBuilders Specialty Ins. Co. RRG*, No. 92436-8, 2017 WL 1532219 (Aug. 17, 2017).

The insurance company's motion was backed by several insurance industry groups that filed amicus curiae briefs, underscoring the importance of the court's ruling.

In a companion order, the court also amended its opinion to clarify that the plaintiff was entitled to recover her costs and attorney's fees.

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