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Washington Supreme Court Extends Efficient Proximate Cause Rule to Third-Party Coverage Disputes

By Michael A. Guadagno

The Washington Supreme Court significantly limited the applicability of an absolute pollution exclusion by application of the efficient proximate cause rule, which had not previously been applied to third-party coverage disputes. Moreover, the Court held as a matter of law that the insurer's denial of coverage pursuant to the absolute pollution exclusion was in bad faith.

In *Xia v. Probuilders Specialty Ins. Co.*, Xia suffered personal injuries from exposure to carbon monoxide in her home. The carbon monoxide escaped into the home because of the negligent installation of a hot water heater exhaust vent. Xia sued the builder. The builder tendered the claim to its insurer. The insurer denied any duty to defend based on a pollution exclusion, arguing the carbon monoxide was a pollutant. The builder settled with Xia and assigned all rights against the insurer. Then came the coverage litigation.

Both the trial court and the court of appeals held there was no coverage pursuant to the policy's absolute pollution exclusion.

Xia then appealed to the Washington Supreme Court. The Court held the efficient proximate cause rule must be applied to determine whether coverage exists. Under Washington law, the rule of efficient proximate cause provides coverage where a covered peril sets in motion a causal chain, the last link of which is an uncovered peril. If the initial event, the "efficient proximate cause," is a covered peril, then there is coverage under the policy regardless of whether subsequent events within the chain, which may be causes-in-fact of the loss, are excluded by the policy. The rule applies only when two or more perils combine in sequence to cause a loss and a covered peril is the predominant or efficient cause of the loss.

The insurer initially argued the rule applies solely to first-party coverage disputes. Indeed, the Court has never applied the rule in third-party liability coverage disputes. However, the Court dismissed this argument, stating simply that the rule has never been explicitly limited to first-party coverage disputes, and, therefore, the Court was free to extend the rule's applicability to third-party coverage disputes. As an aside, the dissent, authored by Justice Madsen, attempted to remind the majority that the Court had previously rejected the rule's applicability to third-party coverage disputes in *Quadrant Corp v. American States Ins. Co.*, 154 Wn.2d 165, 110 P.3d 733 (2005).

In any event, the Xia Court concluded that a covered cause—the negligent installation of the vent—was the efficient proximate cause of the occurrence and, therefore, the policy gave rise to a duty to defend. The Court agreed that the pollution exclusion applied to the facts, but held that it did not bar coverage because pollution was not the efficient proximate cause of the claim.

The Court further held as a matter of law that the insurer's denial was done in bad faith. The Court noted that the insurer conducted no investigation into Washington law that might have alerted them to the rule of efficient proximate cause or its potential application to the absolute pollution exclusion.

The Court remanded the case to the trial court for further proceedings regarding damages for Xia's breach of contract and bad faith claims, as well as the remaining questions of material fact relating to Xia's CPA and IFCA claims.