

Construction Law

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Chair's Report

by Tom Wolfendale – K&L Gates LLP – Seattle, Washington

Dear Section Members:

Seems like yesterday when I sent out my first Chair message to you. In any event, your Council has been busy.

Our Fall Forum was very thought-provoking and encourages debate on the subject of the Independent Duty Doctrine and its place in construction matters. Michael Bond presented this subject, and we extend our thanks to him for that.

We are taking the Council on the road in April 2012, as we journey to the Tri-Cities for a monthly meeting and our expanded Spring Forum. Our newest council member, Alicia Berry from Pasco, has been instrumental in making this happen, and it lets everyone know this is truly a statewide section that tries to serve all of our constituents. The 2012 Mid-Year Annual meeting and CLE are in preparation as well. Also, there exists the possibility that we will be able to present a bonus forum on complex construction litiga-

tion discovery and document management sometime in the first part of 2012.

We are working with the WSBA to enhance our Section website so Section resources are more accessible and so Section members can readily be made aware of upcoming events. In addition, we are striving to further utilize the webinar and webcast capabilities of the Bar in the interest of getting more members involved.

The new contract forms and jury instructions are being earnestly prepared by your Section council, and you should have news of those after the first of the year.

Finally, we welcome Amber Hardwick to the council as the WYLD representative. She already is making us aware of the young and new members of the Bar and their input.

As always, please contact me or any council member with your comments.

Best wishes,
Tom Wolfendale

Your Input Is Needed!

The Construction Law Section Newsletter works best when Section members actively participate. We welcome your articles, case notes, comments, and suggestions concerning new developments in public procurement and private construction law. Please direct inquiries and submit materials for publication to:

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Workers' Compensation v. Tort Act Claims/Concurrent Jurisdiction

by Helaine Honig – Seattle City Attorney's Office – Seattle, Washington

In the case of *Williams v. Leone & Keeble*, 171 Wn.2d 726 (2011), Williams, a Washington resident, worked for an Idaho employment agency. The agency regularly sent him to work for Pro-Set Erectors, an Idaho construction subcontractor. In 2007, Pro-Set was hired by Leone & Keeble (L&K), a Washington general contractor, for a project in Idaho. Later that year, Williams was injured on the job. He filed a claim with the Idaho State Insurance Fund and received workers' compensation payments until late 2008 when the payments stopped. Petitioner filed suit against L&K in Washington, but the trial court dismissed his petition "for want of jurisdiction," and the Court of Appeals affirmed.

L&K argued that a worker's application for and receipt of benefits from the Idaho Industrial Insurance Commission bars that worker from asserting third-party claims against general contractors in Washington. After a pedagogical explication of the distinction between subject matter jurisdiction, *res judicata* and collateral estoppel, Justice Chambers concluded that all of the proffered authorities addressed only whether a final decision regarding whether the injury occurred during the course of employment could be relitigated in the Idaho trial courts. Because the "course of employment" issue may be fatal to a tort action under Idaho law, its determination can lead to the conclusion that a tort claim is barred based upon the doctrines of *res judicata* or collateral estoppel – but not for want of jurisdiction.

In this case, Williams conceded he was injured during the course of his employment, but his suit was not against his employer. His suit was against a third-party Washington general contractor for negligence, a claim allowed under Washington's Industrial Insurance Act. See RCW 51.24.030(1) (allowing claims against third parties "not in a worker's same employ"). That type of controversy – between two state residents – is within the superior court's subject matter jurisdiction regardless of whether some prior factual determinations may have preclusive effect.

The Court went on to opine that even under Idaho law, the benefits Williams received from the Idaho State Insurance Fund would not have preclusive effect on his claim under either the doctrines of *res judicata* or collateral estoppel because there was no final determination regarding the claim or issue. Idaho case law establishes that the State Insurance Fund is simply an insurance carrier. Its assessment regarding a worker's eligibility for benefits does not have the force of a decision and is not the equivalent

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of a decision issued by the Industrial Insurance Commission itself. "A decision by the Industrial Commission has *res judicata* effect only for those issues the Commission actually decides."

Columbia Park Golf Course v. Kennewick

160 Wash. App. 66 (Division 3, February 10, 2011)

by Helaine Honig – Seattle City Attorney's Office –
Seattle, Washington

After a jury awarded \$3M to a developer for breach of a "development option agreement" (DOA) and the implied covenant of good faith and fair dealing, the City of Kennewick appealed the damages award, arguing that the trial judge should have instructed the jury that certain damages were not recoverable as a matter of law, principally under the "new business rule," which can prevent an un-established business from recovering lost profits as damages for breach.

The City leased certain park land from the federal government under a 50-year lease. It operated a golf course and driving range on a portion of the property. Columbia was selected to develop and privatize the golf course operations, and the City granted Columbia a 25-year sublease for that purpose, which it later extended to 31 years with a 10-year renewal option. The sublease was assignable.

During development of the golf course, Columbia learned of another opportunity that would allow it to combine the golf course with an RV campground. To pursue this opportunity, the parties executed the DOA, granting Columbia an exclusive option to develop a "recreational vehicle park, shoreline improvements and boat moorage" in the park.

While the DOA was in effect, the City began negotiating with another developer for an RV park, boat docks, and a community center elsewhere in the park. The City eventually executed another DOA with the second developer although it was aware it potentially conflicted with Columbia's DOA. The City eventually approved the competing development, refused to continue consideration of an RV park within Columbia's existing leasehold, and declined to further extend Columbia's DOA, at which point Columbia sued.

The court made short work of the City's argument that damages were not recoverable as a matter of law because Columbia never secured a modified sublease expressly allowing it to substitute the right to operate an RV park for its original obligation to operate a driving range within its existing leasehold. The court concluded that the weight

of the evidence was that the City had in fact consented to the substitution, and dispensed with the City's argument that the sublease's integration clause required a written amendment with a citation to *Pacific NW Group A v. Pizza Blends, Inc.*, 90 Wn. App. 273, 278 (1998) (parties can modify contract provisions any way they choose, notwithstanding that contract provision required specific action).

More important, the court refused to foreclose contract damages for breach of a contract to negotiate, or even to adopt a presumption limiting damages in such cases to reliance damages (in contrast to expectation damages, which could allow for lost profits), since the "longstanding 'reasonable certainty' requirement already guards against speculative awards." In fact, Columbia only indirectly sought recovery for lost profits. Since Columbia's bundle of rights (40+-year lease, shoreline permit, approved site plan, exclusivity agreement) was assignable, and because it was able to demonstrate the existence of a market for such development rights, Columbia simply asked the jury to award it the market value of this asset it claimed was destroyed. Although Columbia's valuation method (applying a discount rate to projected profits) "parallels the method by which it would have proved lost profits," the court found this so-called "lost asset" measure of damages reliable since it is susceptible to cross-examination and countervailing evidence: the question is not whether the assumptions about future profits would have proved correct, only whether potential investors would have considered them reasonable enough to rely on.

**Zervas Group Architects, P.S. v.
Bay View Tower LLC**

161 Wash. App. 322 (Division 1, April 18, 2011)

by Trent M. Latta – McDougald & Cohen, P.S. –
Seattle, Washington

Affirming the trial court, Div. I Court of Appeals held:

- (1) **A pre-lien notice is not required under RCW 60.04.031 to place a subsequent mortgagee on notice of professional services rendered.**
- (2) **A subsequent mortgagee is placed on notice under RCW 60.04.031 so long as it has reason to know that professional services have been rendered.**

In August of 2005, Zervas Group Architects, P.S. commenced architectural, design and geological work and authorized a geotechnical study, which was completed in November of 2005, for Bay View Tower LLC on a Bellingham condominium project. Bay View later applied for two

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loans from Whidbey Island Bank to finance its “soft costs,” which included preconstruction costs like architectural services. At that time, there was no discussion of services performed by Zervas, and Zervas had not filed a pre-lien notice. The Bank physically inspected the property and observed no visible sign of construction activity. A preliminary commitment for title insurance also confirmed no other recorded liens existed. Based on that information, the Bank made the loans to Bay View and recorded its deeds of trust in April and August of 2006. Thereafter, Bay View acknowledged an outstanding debt owed to Zervas and agreed to seek additional financing while Zervas continued to work on the project. Zervas filed a lien for professional services amounting to \$269,309.20 on July 31, 2007, after Bay View failed to pay the debt in full and commenced a lien foreclosure action.

The trial court ruled Zervas’s lien was prior to the Bank’s two deeds of trust and granted partial summary judgment. Typically, an unrecorded interest in real property is subordinate to a recorded interest. There is an exception, however, for professional service liens, which cannot be recorded until a bill goes unpaid. Professional service liens, therefore, “relate back” to the commencement of the services. (RCW 60.04.061). But because professional services are often not discernable by physical inspection, a provider may record a pre-lien notice of furnishing professional services. The failure to do so, however, renders the professional services lien subordinate to a subsequent mortgagee *so long as* the mortgagee acquires its interests “without notice” of professional services previously provided. (RCW 60.04.031(5)). The appellate court upheld the trial court’s ruling based on its interpretation of the term “without notice” as used in RCW 60.04.031.

The appellate court rejected the Bank’s bright-line argument that a subsequent mortgagee can have “notice” of professional services only if a formal pre-lien notice is recorded. Instead, the appellate court held that a subsequent mortgagee has “notice” if it “has reason to know of the professional services.” In the case before it, the Bank admitted it had actual notice of Zervas’s architectural services, which was alone sufficient to establish the priority of Zervas’s claim. Aside from its actual notice, there was also information available to the Bank from which it could deduce, through implication or inquiry, the existence of Zervas’s services. That Bay View failed to disclose to the Bank the debt owed to Zervas was irrelevant: RCW 60.04.031(5) requires that a lender have notice of the professional services rendered and not of the debt owed.

Accordingly, the Bank’s April and August of 2006 deeds of trust were subordinate to Zervas’s July 31, 2007, lien because the Bank had notice of the services rendered by Zervas, which related back to their commencement in August of 2005.

**Condominiums/Construction Defects/
 Implied Warranties/Appearance
 in Court/LLCs/Necessity of Legal
 Counsel**

*Marina Condominium Homeowner’s Ass’n v.
 Stratford at Marina, LLC*

161 Wn. App. 249, 254 P.3d 827 (Div. 1, 2011)

*by Amber Hardwick – Green & Yalowitz, PLLC –
 Seattle, Washington*

Summary: The trial court granted the homeowners’ association partial summary judgment against developer for breaches of the implied warranty of quality under Washington’s Condominium Act, and granted default judgment and Civil Rule 11 sanctions against the developer. The appellate court reversed in part and affirmed in part, holding: (1) the implied warranty of quality applies only to improvements the developer made or contracted for; (2) default judgment findings were insufficiently supported; and (3) the rule requiring corporations appearing in court proceedings to be represented by an attorney extends to limited liability companies.

The Stratford at the Marina, LLC (“Stratford”) started a condominium conversion project. During the conversion project, Stratford undertook improvements to some but not all of the property conditions. Subsequently, the Marina Condominium Homeowners’ Association (“HOA”) filed suit alleging, among other things, breach of the implied warranty of quality under the Condominium Act. The HOA identified 16 allegedly defective conditions. Due to financial difficulties, Stratford proceeded mostly without counsel and designated George Webb, a non-attorney representative, to act on Stratford’s behalf in the litigation.

Implied Warranty of Quality

The HOA brought a motion for partial summary judgment to establish breach of an implied warranty of quality under the Condominium Act. The trial court granted the motion, and identified each of the 16 defects as breaches of the “implied warranties set forth in RCW 64.34.445(2).”

The Court of Appeals reversed. RCW 64.24.445(2) contains “two distinct warranties”: (1) the warranty of suitability and (2) the warranty of quality construction. The warranty of quality construction extends only to “any improvements made or contracted for’ by Stratford – it does not apply to original construction work that predated Stratford’s improvement work.” Stratford could not be held liable for defects which pre-existed the condominium conversion under the warranty for quality unless the HOA could establish that Stratford performed work on each

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CONDOMINIUMS/CONSTRUCTION DEFECTS/IMPLIED WARRANTIES/APPEARANCE IN COURT/LLCS/NECESSITY OF LEGAL COUNSEL from previous page

alleged defect. The appellate court declined to affirm on the alternative ground that the HOA established a breach of the warranty of suitability, stating: “[T]he HOA’s motion focused on original construction work and on the condominium’s compliance with construction standards and laws, without ever discussing the general suitability of the condominiums.”

Discovery Sanctions

The parties engaged in contentious discovery. Shortly before trial, default judgment was entered against Stratford for failures to timely respond to written discovery or to fully answer deposition questions. Though the trial court’s default judgment stated that lesser sanctions were considered, the appellate court reversed on the basis that “the trial court failed to make a clear record in the order containing its reasoning in reaching those conclusions.”

CR 11 Sanctions

The trial court imposed Civil Rule 11 sanctions against Stratford for filing a motion signed by a non-attorney designee. Civil Rule 11 states, in part:

Every pleading, motion, and legal memorandum of a party represented by an attorney shall be dated and signed by at least one attorney of record in the attorney’s individual name A party who is not represented by an attorney shall sign and date the party’s pleading, motion or legal memorandum and state the party’s address.

Stratford filed a motion to continue a summary judgment hearing signed by Mr. Webb as the designated representative for Stratford. The HOA objected and moved to strike on the basis the signature did not comply with CR 11 and was untimely filed. The trial court granted the motion. The appellate court affirmed, stating:

Corporations appearing in court proceedings must be represented by an attorney. *Lloyd Enters., Inc. v. Longview Plumbing & Heating Co., Inc.*, 91 Wn. App. 697, 701 P.2d 1035 (1998). LLCs, like corporations, are artificial entities that act only through member/agents. The rule applied to corporations in *Lloyd*, applies equally to LLCs.

While a layperson may continue to represent himself or herself in court proceedings, an attorney must appear on behalf of an LLC or corporate entity. Since the trial court did not abuse its discretion, the appellate court upheld the CR 11 sanctions.

Recovery Under Indemnity in Lieu of Breach of Construction Contract Claims Barred by the Statute of Limitations/Subcontractors’ Liability for Cost of Repairs Not Within Its Scope of Work

Harmony at Madrona Park Owners Assoc. v. Madison Harmony Development Inc.
160 Wn. App. 728, 253 P.3d 101 (2011)

by Casey L. Lund, Attorney and E. Tyler Howell, Law Clerk –
Winston & Cashatt – Spokane, Washington

The Division One Court of Appeals recently revisited *Harmony at Madrona Park Owners Assoc. v. Madison Harmony Development Inc.*¹ (*Harmony I*), a 2008 case where it reversed the trial court’s award of damages to the general contractor for a subcontractor’s breach of contract based on a defect in construction, holding the claims were barred by the 6-year statute of limitations imposed on contracts. On remand, the trial court granted the general contractor’s motion for summary judgment, awarding damages in the same amount as the original breach of contract damages based on an indemnification clause in the contract.

On second appeal, the court held: 1) the subcontractor has the burden of proving that a general contractor’s settlement with another entity included recovery for repairs other than those required to correct subcontractor’s defective work; and 2) a subcontractor may be liable for indemnity damages for the cost of repairing materials not within the subcontractor’s scope of work.

History

Ledcor Industries was the general contractor on a 25-building condominium project in Bellevue, Washington. The homeowners’ association sued the developer of the project, who subsequently filed suit against third-party defendant Ledcor for construction defects. After settling with the developer and the HOA, Ledcor amended its complaint to include fourth-party defendant, Serock Construction, for breach of contract and indemnification for defects in the window trim installed by Serock.

Ledcor contracted with Serock to install exterior trim on 13 buildings in phase I of the project. The subcontract required Serock’s work to be done “in a workmanlike and substantial manner.”² The contract also required Serock to “defend, indemnify, and hold Ledcor and Madison harmless from any and all claims, demands, losses, and liabilities arising from, resulting from, or connected with work performed under the subcontract.”³

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RECOVERY UNDER INDEMNITY IN LIEU OF BREACH OF CONSTRUCTION CONTRACT CLAIMS BARRED BY THE STATUTE OF LIMITATIONS... from previous page

The trial court awarded damages to Leducor based on breach of contract on 11 of 13 buildings, but held that the statute of limitations barred recovery on 4 of the 11 buildings. In lieu of an award based on breach of contract, the court awarded Leducor damages for the four buildings barred by the statute of limitations based on the indemnification agreement.

Harmony I

On appeal, the Division I Court of Appeals held that the statute of limitations period expired six months prior to Leducor filing suit against Serock.⁴ Accordingly, damages for breach of contract were overturned and the case was remanded. The court directed the trial court, stating: "nothing in this opinion precludes the trial court from considering whether Leducor is entitled to indemnification for repairing the seven other buildings, for which the trial court erroneously awarded damages under a breach of contract theory."⁵

Following the appellate court's lead on remand, the trial court granted Leducor's motion for summary judgment, awarding indemnity damages to Leducor in the amount of \$127,500. This figure is the same amount the court of appeals denied as contract damages being barred by the statute of limitations.

Harmony II

Serock again appealed the trial court's ruling, asserting that they should not be liable for the cost of repairing defective metal flashing that was not installed by them and was outside their scope of work. The court disagreed with this argument. Recognizing that indemnity is an "equitable cause of action" that requires "full reimbursement," the court reasoned that the cost Leducor incurred in the course of repairing Serock's work may reasonably include the cost of repairing the flashing.⁶ Regardless of whether the flashing was defective or not, it had to be replaced when correcting Serock's trim defects. Accordingly, the court affirmed the trial court's award of indemnity damages.

Serock also appealed the trial court's ruling that in requesting setoff, it held the initial burden of proving Leducor had already recovered for Serock's defects under settlements with other subcontractors. Again, the court of appeals rejected this assertion. In doing so, the court reasoned that shifting the burden of proof to the party seeking indemnity "would encourage litigation and reward the nonsettling [party] for refusing to settle."⁷ Serock's claim for setoff was denied.

At first glance, these cases raise questions about how Leducor was able to recover under indemnity for what were substantially breach of contract damages that were barred by the statute of limitations and the statute of

repose applied to construction defect claims. The trial court appears to rely on *Central Washington Refrigeration v. Barbee*⁸ for the proposition that the statute of limitations on indemnity claims does not begin to run until "the party seeking indemnity pays, or is legally adjudged obligated to pay damages to a third party." Applying that principle here, the statute of limitations began to run when Leducor settled with the developer for defects in Serock's work. Accordingly, Leducor's recovery under indemnity was not precluded by the same statute of limitations that ultimately barred its breach of contract claim.

Summary

Harmony I & II indicate that an attorney representing a general contractor seeking damages for breach of contract where the subcontract contains an indemnity clause should include a claim for indemnity in addition to the claim for breach of contract in the initial complaint against the subcontractor. This may obviate the burdensome process of multiple trials and multiple appeals that occurred in *Harmony I & II*.

1 143 Wn. App. 345, 177 P.3d 755 (2008).

2 *Id.* at 351.

3 *Id.*

4 *Id.* at 357 (providing a detailed discussion of the statute of limitations, statute of repose, the discovery rule, and affirmative defenses in construction defect claims).

5 *Id.* at 359.

6 *Harmony II*, 160 Wn. App. 728, 253 P.3d 101, 106 (2011).

7 *Id.* 253 P.3d at 105 (quoting *Puget Sound Energy v. ALBA Gen. Ins. Co.*, 149 Wn.2d 135, 141, 68 P.3d 1061 (2003)).

8 133 Wn.2d 509, 517, 946 P.2d 760, 764-65 (1997).

Insurance/Breach of Good Faith Duty to Defend/Lack of Covenant Judgment

Unigard Ins. Co. v. Mutual of Enumclaw Ins. Co.
160 Wn. App. 912, 250 P.3d 121 (2011)

by Casey Lund, Attorney and Craig Lawrence Friedrichs, Law Clerk – Winston & Cashatt – Spokane, Washington

History

An individual (Vendor) bought property in 1979 that was formerly used as a dry cleaning facility and subsequently sold it to a general partnership (Purchaser) in 1981. More than a decade later, the Washington State Department of Ecology notified the Purchaser that it could be liable for the release of hazardous materials under the Model Toxics Control Act. To prevent liability, Purchaser entered into a voluntary clean-up program and incurred the costs.

Thereafter, Purchaser sued Vendor for contribution. Vendor tried to tender defense to his insurance provider, Mutual of Enumclaw Insurance Company (MOE), who denied coverage and refused to defend.

Vendor settled with Purchaser, agreeing to pay \$20,000 and assigning his rights against Vendor's Insurance Company. Subsequently, Purchaser assigned those rights to its own insurer, Unigard Insurance Company (Unigard). Unigard sued MOE for breach of contract, bad faith, and violation of the Consumer Protection Act (CPA). After both sides moved for partial summary judgment on the issue of liability, the trial court granted Unigard's motion.

The parties proceeded to trial on the remaining issue of damages owed by MOE for its bad faith conduct. Testimony established damages for attorneys' fees incurred, bills paid to investigate and clean the site, and future clean-up costs. At the end of the jury trial, the jury returned a verdict of \$1,033,488.99 in past economic damages and \$312,500 in future economic damages. The court awarded prejudgment interest on the past damages, \$10,000 in treble damages under the CPA, and attorneys' fees and costs of \$154,260.46. Ultimately, the final judgment entered was for \$2,023,837.20. MOE unsuccessfully moved for a new trial and appealed.

Analysis

Insurers have a duty to act in good faith, and a failure to do so is actionable in tort. An insurer is liable for the tort of bad faith if the insurer breaches its good faith duty to defend. If the insurer is found to have acted in bad faith in failing to defend, the insurer is estopped from asserting coverage defenses and could face liability in excess of policy limits. The following cycle frequently arises in these types of insurance cases with respect to assertions of bad faith:

- 1) A defendant is sued and seeks coverage;

- 2) Defendant's insurer refuses to defend;
- 3) Defendant enters into a settlement agreement with plaintiff;
- 4) Defendant stipulates entry of a judgment and assigns to the plaintiff any claims against the insurer in exchange for the plaintiff's promise not to execute the judgment against the defendant (also known as a *covenant judgment*);
- 5) The plaintiff sues the insurer for bad faith and related claims, seeking to recover the agreed settlement amount; and
- 6) If insurer is liable for bad faith and the covenant judgment is reasonable, there is a presumption that the measure of damages is the amount of the covenant judgment.

Where there is a covenant judgment, the plaintiff, standing in the defendant's shoes, attempts to recover the amount of the judgment from the insurance company for bad faith and any related claims. If the plaintiff is successful, the insurer is presumptively liable for the amount agreed upon in the covenant judgment. Importantly, there was no covenant judgment in this case, and the Vendor did not admit liability or stipulate to a judgment amount. As a result, damages remained an issue for trial, and instead of liability limited to the amount of a covenant judgment, MOE faced more than \$2 million in damages.

Thereafter, the appellate court refused to allow MOE to submit the question of liability to the jury. MOE gave up the right to pursue that claim when it refused to defend the Vendor in the first place. MOE also insisted that the failure to hold a reasonableness hearing to attempt to prove that the covenant judgment was reasonable was also error. However, MOE failed to cite authority demonstrating that a reasonableness hearing is required in the absence of a covenant judgment. The reasonableness hearing is designed to dispel collusion between the settling parties against an insurance company. However, because there was no settlement between the parties, a reasonableness hearing was unnecessary under the present facts.

MOE also attempted to show prejudice under ER 401 and 403 that the evidence presented a substantial risk of enflaming the jury. MOE did not show that the information affected the outcome of the trial, and there was no abuse of discretion. MOE's assignment of error for failure to award a new trial was similarly dismissed because it could not show that the court committed reversible error.

However, MOE was successful in one portion of the appeal: the rate of interest applied toward the award of prejudgment interest. The four categories for prejudgment interest in Washington correspond to different rates of interest: (1) breach of contract where the interest rate is

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**INSURANCE/BREACH OF GOOD FAITH DUTY TO DEFEND/
LACK OF COVENANT JUDGMENT** from previous page

specified, (2) child support, (3) tort claims, and (4) all other claims. The trial court determined that category four applied, which called for an interest rate of 12%. The appellate court found MOE's citation to *Woo v. Fireman's Fund Ins. Co.*¹ persuasive. In that case, the tort prejudgment rate of interest applied where an insurance company had failed to defend as the nature of the dispute between the insurer and insured was one of bad faith. The appellate court held that because the bad faith aspect of the case dominated the contract aspect, the tort prejudgment interest rate of recovery was appropriate.

Summary

It has been consistently held that an insurer who breaches the duty to act in good faith and is found liable for the tort of bad faith is estopped from asserting coverage defenses, and liability in excess of policy limits may be imposed on the insurer. Here, the court was not limited to the \$20,000 damages incurred by its policy holder and the submission of the question to a jury resulted in a judgment of over \$2 million. This result probably could have been avoided had the insurer defended under a reservation of rights.

1 150 Wn. App. 158, P.3d 557 (2009).

**Mechanics' Liens/Construction
Management Services/Non-Lienable**

by Larry Vance – Winston & Cashatt – Spokane, Washington

In the case of *Blue Diamond Group v. KB Seattle 1, Inc.*, 163 Wash. App. 449 (2011), Division I of the Court of Appeals held that construction management services provided by the claimant were not lienable services under Washington's mechanic's lien statute.

The lien claimant (Blue Diamond Group) provided construction management services to a company called Kudo Beans (KB Seattle), a franchisee which leased certain kiosk space in the Southcenter Mall. The lease was for 659 square feet of space, and the lease agreement permitted KB Seattle to make the tenant improvements in the leased space. Blue Diamond entered into a contract with KB to manage the construction of its coffee kiosk. Work on the coffee stand was completed, but Blue Diamond did not receive payment for its work on the construction management contract. Blue Diamond recorded a lien against the improved property in the amount of the unpaid contract balance of \$77,615.62. When Blue Diamond went to foreclose its lien, the lessor (Southcenter) moved for summary

judgment. The trial court granted said motion for summary judgment on two bases: 1) Blue Diamond did not register as a contractor under RCW Ch. 18.27; and 2) Blue Diamond also had not provided lienable services under Washington law. The trial court granted summary judgment dismissing Blue Diamond Group's lien foreclosure action.

On appeal the Court of Appeals first took on the issue of whether construction management services were lienable under RCW 60.04.021. Said statute provides that any person furnishing "labor, professional services, materials, or equipment for the improvement of real property shall have a lien upon the improvement." The court first held that the claimant's services did not constitute "labor" within the meaning of the Lien Act. The court also cited a previous case which held that management and coordination services did not fall within the statutory definition of "labor" at the improved property site.¹ Here, there was nothing to show that any labor was performed at the site of the improved property. Hence, the court determined that it was not "labor" as provided for by the lien statute.

The court also held that Blue Diamond's work did not constitute "professional services," within the meaning of the Lien Act. This point was interesting because the lien statute specifically defines professional services as including surveying, establishing or marking the boundaries of, preparing maps, plans, or specifications for, or inspecting, testing or otherwise performing any other architectural or engineering services for the improvement of real property. Stating that the court was determining the legislative intent, the court held that this situation was governed by the well-known principle of statutory interpretation, "*expressio unius est exclusio alterius*" (or in common English, the expression of one thing implies the exclusion of all omissions). Or stated differently: where the statute specifically lists certain things upon which it operates there is a presumption that the legislative body also intended all omissions. (If anyone truly believes that the legislative intent can be determined by this principle, then they need to watch the legislature in action.) In any case, the court has now determined that the lien statute does not cover construction management services. And, because the court first determined that the claimant's services were not lienable, the court basically was able to avoid addressing the contractor licensing issue, stating simply that it need not decide this question.

1 The prior decision relied upon was *Pacific Industries v. Singh*, 120 Wn. App. 1, 8-9 (2003).

Engineer Liability/Economic Loss/ Contracting Parties/Tort Claims/ Independent Duty

by Larry Vance – Winston & Cashatt – Spokane, Washington

In the case of *Donatelli v. Strong Consulting Engineers*, 163 Wash. App. 436 (2011), Division One of the Court of Appeals continued the movement to swallow up and replace the economic loss rule with the independent duty doctrine.

In the *Donatelli* case, the defendant-engineer had contracted to perform six phases of consulting engineering services for the plaintiff-developer. Basically, the engineer was to provide consulting engineer support for the developer's project, which was ultimately to create two short plats. In October 2002, the local county issued a 5-year preliminary plan approval for the project. The project was not, however, completed within 5 years, and the permit approval expired. In October 2007, the engineer assisted the plaintiff-developer in obtaining a new preliminary approval for the project. Unfortunately, by that time, the real estate market had begun its rapid decline, and before the plaintiff-developer could obtain final plat approval for the project, the real estate development market had essentially collapsed. The developer then ran out of money and ultimately lost the property through foreclosure.

The plaintiff-developer brought suit against the engineer alleging claims of 1) breach of contract, 2) negligence, 3) negligent misrepresentation, and 4) a Consumer Protection Act claim. The engineer's legal counsel brought a motion for summary judgment seeking to dismiss all claims, other than the breach of contract, on the basis of the economic loss rule. The trial court granted partial summary judgment dismissing the Consumer Protection Act claim, but denied the defendant-engineer's motion for partial summary judgment on both the negligence and negligent misrepresentation claims (holding that the negligence claims may proceed against the defendant-engineer because they were no longer barred by the economic loss rule, which had been replaced by the independent duty doctrine). This was despite the fact that the plaintiff-developer (individually) had signed a contract for engineering services which included a limitation of liability of \$500 or the fee charged by the engineer, whichever was greater. This limitation of liability could be removed or waived on the client's written request and the payment of an additional 5% of the total engineering fee or \$500, whichever was greater. **The developer did not request a waiver of the contractual limitation of liability provision. Nonetheless, the court simply brushed the contractual limitation of liability aside, indicating that where there is an independent duty that rests separate from the contract, breach of that duty will be "actionable despite**

the contract." Curiously, the court goes on to say that the *Berschauer Phillips* case "does not control the disposition of this case, despite the fact that it lives on."

Based upon the Supreme Court of Washington's recent opinions in the *Eastwood v. Horse Harbor Foundation* and *Affiliated FM Ins. Co. v. LTK Consultant Services* cases, the court basically held that the economic loss rule no longer would apply and it would be known as the independent duty doctrine. The engineer's efforts to distinguish the two earlier cases by the Washington Supreme Court were not persuasive to the Court of Appeals. The Court of Appeals also indicated, however, that it was not addressing causation or damages other than elements of a tort claim because these and other related questions were not currently before the court.

Concerning the negligent misrepresentation claim (which the developer was allowed to pursue), the alleged misrepresentations by the engineer were that (1) the project "should be completed within approximately one and 1/2 years, if not less time and (2) that the project should take no more than \$50,000 to complete."

Editor's comment: The court's decision in this case is somewhat puzzling at best, and also seems very short-sighted, especially as concerns the treatment of the limitation of liability clause in the parties' contract. The entire court movement to suddenly trash the economic loss rule reminds one of the saying, "burning the barn to roast the pig." It also seems to illustrate the point once made by Justice Felix Frankfurter when dealing with the misuse of the doctrine of assumption of risk:

The phrase "assumption of risk" is an excellent illustration of the extent to which uncritical use of words bedevils the law. A phrase begins life as a literary expression; its felicity leads to its lazy repetition; and repetition soon establishes it as a legal formula, indiscriminately used to express different and sometimes contradictory ideas. Thus, in the setting of one set of circumstances, "assumption of risk" has been used as a shorthand way of saying that although an employer may have violated the duty of care which he owed his employee, he could nevertheless escape liability for damages resulting from his negligence if the employee, by accepting or continuing in the employment with "notice" of such negligence, "assumed the risk." In such situations "assumption of risk" is a defense which enables a negligent employer to defeat recovery against him.

Tiller v. Atlantic Coast Line R. Co., 318 U.S. 54 at 68-69 (1942).

The problem with the economic loss rule was much the same as with the doctrine of assumption of risk: an "uncritical use of words," its felicity leading to its "lazy repetition," and its repetition soon establishing it as a "legal formula" indiscriminately used to express different and often contradictory situations.



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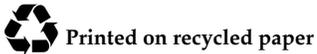
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