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No. 69644-1-I

IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON
DIVISION I

Erik D. Ensberg, Appellant,

v.

Jason D. Nelson and Francine E. Nelson, Respondents,

BRIEF OF RESPONDENTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Table of Cases **Page**

Statutes

I. RESTATEMENT OF FACTS

The Statement of Facts set forth in the Appellant's brief is essentially correct. Respondents offer the following facts to expand on and clarify that statement. At the time of the sale of lot 18 in Key Bay from the appellant Erik Ensberg (hereafter "Ensberg") to the respondents Jason and Francine Nelson (hereafter "Nelson"), there was a judgment against the Key Bay Homeowners' Association (hereafter 'HOA') of record with the Chelan County Auditor. (EX. 6). The HOA is the governing body for the Key Bay subdivision in which lot 18 is located. The judgment was entered on March 17, 2008 and was in the amount of $523,474.00 with interest accruing on the judgment at 12% per annum. It was recorded with the Chelan County Auditor on April 8, 2008. (F/F 1.6) That judgment was not shown as an exception on the statutory warranty deed from Ensberg to Nelson (EX 2).

After the purchase of lot 18 from Ensberg in February 2009, Nelson listed the property for sale. (RP 13, lines 20 - 22) In early October 2009, Nelson received an offer on the lot and after some negotiations back and forth with the potential buyers, an agreement was reached to sell the lot for $216,000.00 (RP 13, lines 22 – 24; EX 15). This amount would have been sufficient to pay the underlying debt on the property, the closing costs, real estate commissions, taxes and so forth and provide a

small profit to Nelson. After the purchase and sale agreement was signed, the transaction was placed with escrow in Wenatchee and a title commitment was obtained.

The title commitment listed various encumbrances on the title including the deed of trust in favor of Ensberg. (EX 26). The title commitment also listed as an encumbrance the March 17, 2008 judgment against the Key Bay Homeowners' Association. Paragraph 12 of Schedule B of the title commitment provided the following exception:

12. JUDGMENT:

AGAINST:	KEY BAY HOMEOWNERS ASSOCIATION, ET AL
IN FAVOR OF:	DEEP WATER BREWING, LLC
AMOUNT:	$523,474.00
CHELAN COUNTY JUDGMENT	NO: 08-9-00369-8
SUPERIOR COURT CAUSE	NO: 02-2-00848-2

The buyers exercised their contractual right to disapprove any matter on the title report and on October 24, 2009 they executed an addendum to the purchase and sale agreement requiring the removal of the judgment against the homeowners' association as an encumbrance. (EX 31). The buyers also required Nelson to agree to the following:

> Buyer shall not be liable for any judgment settlement amount presently or in the future owed by the Key Bay Homeowners Association et al in regard to exception #12 in Schedule B involving the judgment in favor of Deepwater Brewing, LLC. Seller will pay off their share of any judgment settlement amount related to their liability due from them as a result of the judgment in favor of Deepwater Brewing LLC prior to closing.

(EX 31; RP 18, lines 2 – 5). Nelson did not agree to this, but urged the title company to revisit the judgment issue. On October 29, 2009, the judgment under Schedule B of the title report was removed as an esceiption and instead it was included as a "Note" in the title commitment (EX 27):

> NOTE 10: JUDGMENT:
>
> | | |
> |---|---|
> | AGAINST: | KEY BAY HOMEOWNERS ASSOCIATION, ET AL |
> | IN FAVOR OF: | DEEP WATER BREWING, LLC |
> | AMOUNT: | $523,474.00 |
> | CHELAN COUNTY JUDGMENT | NO: 08-9-00369-8 |
> | SUPERIOR COURT CAUSE | NO: 02-2-00848-2 |
>
> THE JDUGMENT AGAINS THE KEY BAY HOMEOWNERS' ASSOCIATION, A WASHINGTON NONPROFIT CORPORATION (THE "ASSOCIATION"), HAS NOT ATTACHED TO THE TITLE TO THE LAND DESCRIBED IN SCHEDULE A HEREIN. IF, AFTER APPEAL, THE JUDGMENT ATTACHES TO THE ASSOCIATION'S INTEREST, THE ASSOCIATION MAY LEVY ASSESSMENTS AGAINST EACH LOT TO RECOVER THE FUNDS OWED TO THE JUDGMENT CREDITOR. THIS NOTE PROVIDES NOTICE OF THE POTENTIAL FUTURE LIABILITY FOR SUCH ASSESSMENT(S).

This "Note" made matters worse in the buyers mind and on November 4, 2009, the buyers sent Nelson a Rescission of the purchase and sell agreement, which Nelson signed on November 7, 2009, the original closing date of the transaction (EX 32)..

II. ARGUMENT

A. **The judgment against the Key Bay Homeowners' Association, and the possibility of an assessment by the homeowners'**

association to pay the judgment, was an encumbrance on the property conveyed by Ensberg to Nelson.

By conveying the property by a statutory warranty deed, Ensberg warranted to Nelson the following:

> (1) that at the time of making and delivery of such deed he or she was lawfully seized of an indefeasible estate in fee simple, in and to the premises therein described, and had good right and full power to convey the same; (2) that the same were then free from all encumbrances; and (3) that he or she warrants to the grantee, his or her heirs and assigns, the quiet and peaceable possession of such premises, and will defend the title thereto against all person who may lawfully claim the same, . . .

RCW 64.04.030.

Sixty four years ago, our Supreme Court in *Hebb v. Severson,* 32 Wn. 2d 159, 169, 201 P.2d 156 (1948). broadly defined "encumbrance" to be

> any right to, or interest in, land which may subsist in third persons, to the diminution of the value of the estate of the tenant, but consistent with the passing of the fee; **and also, as a burden upon land depreciative of its value,** such as a lien, easement, or servitude, which, though adverse to the interest of the landowner, does not conflict with his conveyance of the land in fee.

Hebb v. Severson, supra at 167 (emphasis added). In other words, for a matter to be an "encumbrance" the matter does not have to defeat the grantor's title. Any matter that tends to diminish the value of the property it is an encumbrance that the grantor warrants against in the warranty deed.

The title insurance company that issued the commitment for title insurance for the Nelson's attempt to sell lot 18, recognized that the homeowners' association could assess all lot owners to raise funds to pay the judgment. There are no reported Washington cases on this issue. However, at least one appellate court in California concluded such a remedy is available to a judgment creditor of a homeowners' association. *See, O'Toole v. Kingsbury Court Owners Assn.* 126 Cal.App.4th 549 (2005). In that case, an insurance adjuster had contracted with the owners' association to obtain insurance proceeds due the association. Even though the association received the insurance proceeds, it refused to pay the insurance adjuster. The adjuster sued for breach of contract and was awarded damages of $140,196.59 and pre-judgment interest of $59,881.19. The judgment creditor obtained an order compelling the association to levy an assessment against the individual owners to pay the judgment. When the association refused, the court appointed a receiver to do so.

B. **The judgment against the HOA rendered the title to lot 18 unmarketable.**

An appellate court can and will decide a case on any legal theory established by the pleadings and supported by the proof, regardless of the theory applied below. *Barber v. Peringer,* 75 Wn.App. at 248, 877 P.2d

223 (1994). Although the trial court rendered judgment against Ensberg based on a breach of the covenant against encumbrances, the judgment against the HOA also affected the market value of the real property and Ensberg breached his duty to convey good and marketable title. A seller of real property is required to convey good and marketable title to a purchaser:

> Even in the absence of any provision in the contract indicating the quality of the title provided for, the law implies an undertaking on the part of the vendor to make and convey a good and marketable title to the purchaser. 55 Am. Jr. 619, Vendor and Purchaser, § 149; notes (1928), 57 A.L.R. 1256, 1260, wherein Washington cases in support of the rule are collected.

Hebb v. Severson, supra, at 169. In *Shinn v. Thrust IV, Inc.* 56 Wn. App. 827, 786, P.2d 286 (1990), Division I of the Court of Appeals, relying on *Hebb v. Severson, supra.,* held that the mere possibility of enforcement of restrictions that might not even apply to the land in question, was enough to make the title unmarketable. The Court of Appeals noted that

> The Washington Supreme Court has defined marketable title as one being free of reasonable doubt and such as a reasonably informed and intelligent purchaser, exercising ordinary business prudence, would be willing to accept. Such a title need not be perfect in the sense that it is free from every conceivable technical criticism or suspicion, but only from those possibilities of a defect which would give rise to a reasonable question as to its validity.

Shinn v. Thrust IV, Inc., supra, 786 P.2d at 296. The Court of Appeals went on to quote a portion of the Supreme Court's decision in *Hebb v. Severson*:

> [e]very purchaser of land has a right to demand a title which shall put him in all reasonable security, and which shall protect him from anxiety, lest annoying, if not successful suits be brought against him, and probably take from him or his representative, land upon which money was invested. He should have a title which shall enable him not only to hold his land, but to hold it in peace; and if he wishes to sell it, to be reasonably sure that no flaw or doubt will come up to disturb its marketable value.

Hebb v. Severson, supra at 166-67. Like the restriction at issue in the *Shinn* case, the judgment here cast serious doubts about whether any purchaser of lot 18 had reasonable security that his or investment in lot 18 would not be in jeopardy. The proof at trial clearly established that the effect of the judgment against the HOA was uncertain and that it was reasonable to assume that litigation might ensue to force the HOA to assess lot owners to pay the judgment. The judgment against the HOA was a "flaw or doubt" which, when Nelson attempted to sell lot 18, came up to "disturb its marketable value."

C. Ensberg's failure to convey unencumbered and marketable title to Nelson constituted a failure of consideration for the promissory note.

The promissory note executed by Nelson in favor of Ensberg was given in consideration for the purchase of an unencumbered and marketable title to lot 18. At the time of the conveyance lot 18 was encumbered by the judgment against the HOA and the lot could not be sold due to the uncertainty of the effect of that judgment on lot owners in Key Bay. A material breach of the underlying contract may constitute a failure of consideration and may be raised in defense to an action on an unpaid instrument. *Burton v. Dunn,* 55 Wash.2d 368, 347 P.2d 1065 (1960).

Here, Ensberg materially breached his obligation to convey unencumberd and marketable title which was the consideration for Nelson's promise to pay the promissory note. The trial court was correct in finding a failure of consideration and dismissing Nelson's complaint on the promissory note.

D. There was sufficient evidence to support the courts award of damages.

Where the trial court has evaluated evidence, the appellate court's review is limited to determining whether the findings are supported by substantial evidence. *Standing Rock Homeowners Ass'n v. Misich,* 106 Wn.App 231, 23 P.3d 520 (2001). The appellate court will draw

reasonable inferences from the facts in favor of the trial court's determination. *Henry v. Bitar,* 102 Wn.App 137, 5 P.3d 1277 (2000).

Ensberg simply misstates the finding made by the trial court. At page 27 of his brief Ensberg states: "Thus it was an abuse of discretion by the court to enter a finding at Finding of Fact 1.29 that the property sold at a trustee's sale for $129,733.00." The actual finding was that at the time of the sale, the principal balance of the first deed of trust was $129,733.00. (F/F 1.29). That was the principal amount of the obligation secured by the first deed of trust at the time of the attempted sale by Nelson. (EX 34). The court also made a finding that Nelson stopped making payments to the holder of the first deed of trust (F/F 1.27) and it was reasonable to infer that the principal balance at the time of the sale was the same as the principal balance when the attempted sale by Nelson fell through.

It is well settled that damages need not be proven with mathematical certainty. *Interlake Porsche & Audi v. Bucholz,* 45 Wn.App. 502, 728 P.2d 597 (1986). Evidence of damage is sufficient if it affords a reasonable basis for estimating the loss and does not subject the trier of fact to mere speculation or conjecture. *Id.* Where damages cannot be ascertained with certainty, the trial court must exercise its sound discretion. *Id.*

The trial court concluded that the fair market value of lot 18 without the encumbrance was $216,000.00 based on the offer to purchase the property in October 2009. The trial judge then found that the value of lot 18 subject to the uncertainty of the HOA judgment was the principle amount owing on the first deed of trust: $129,733.00. The trial judge's determination of the amount of diminished value was not based on speculation and conjecture but on the exercise of sound discretion.

E. The trial court properly awarded Nelson their attorney's fees.

At page 32 of his brief, Ensberg makes the following statement:

> In the case at bar, even if this court does not reverse the trial court's decision, attorneys fees should not be awarded to Nelson. Nelson is not entitled to attorneys fees because at no time did Nelson tender the case to Ensberg to clear title.

Ensberg does not cite any authority for that argument and misunderstands the basis on which the trial court granted Nelson attorney's fees. Ensberg sued Nelson on the promissory note which contained an attorney fee provision. Because Ensberg did not prevail on that claim and Nelson was the prevailing party on that claim, Nelson was entitled to attorney's fees under the attorney fee provision in the promissory note.

F. Nelson is entitled to their attorney's fees on appeal.

In his complaint, Ensberg sought attorney's fees against Nelson under the attorney fee provision in the promissory note. Once plaintiffs alleged that they were entitled to attorney's fees from Nelson, that triggered the Nelsons' right to attorney fees. RCW 4.84.330 provides:

> In any action on a contract or lease entered into after September 21, 1977, where such contract or lease specifically provides that attorney's fees and costs, which are incurred to enforce the provisions of such contract or lease, shall be awarded to one of the parties, the prevailing party, whether he is the party specified in the contract or lease or not, shall be entitled to reasonable attorney's fees in addition to costs and necessary disbursements. Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract or lease which is entered into after September 21, 1977. Any provision in any such contract or lease which provides for a waiver of attorney's fees is void. As used in this section "prevailing party" means the party in whose favor final judgment is rendered.

Washington courts have consistently held that this statute applies to any action in which it is alleged that a party is liable on a contract, even if no contract exists. *See Herzog Aluminum v. General American,* 39 Wn. App 188, 692 P.2d 867 (1984); *Western Stud Welding v. Omark Indus.,* 43 Wn. App. 293, 716 P.2d 959 (1986); *Labriola v Pollard Group,* 152 Wn.2d 828, 100 P.3d 791 (2004). Because plaintiffs have alleged a right to attorney fees from defendants, Key, Johnson the HOA are entitled to an award of its attorney's fees incurred on this appeal.

III. CONCLUSION

The trial court here used the expansive definition of "encumbrance" in finding that the existence of judgment against the HOA constituted a breach of Ensberg's statutory warranty deed. The judgment against the HOA also created a reasonable doubt as to the effect of the judgment on the value of lot 18, could have subjected the owner to litigation and resulted in an assessment levied against the property. Such an assessment could have become a lien which, if not paid, could have resulted in a loss of title to the property.

The trial court's award of diminished value damages was supported by competent evidence and was within the sound discretion of the trial court. The court was correct in awarding attorney's fees to Nelson and Nelson is entitled to fees on this appeal. The trial court judgment should be affirmed.

RESPECTFULLY SUBMITTED this 5th day of June, 2013.

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Attorney for Respondents