No. 32122-3-III

COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION III

HSC REAL ESTATE, INC., a Washington corporation,

Appellant,

v.

VMSI, LLC, a Washington limited liability company,

Respondent.

REPLY BRIEF OF APPELLANT HSC REAL ESTATE, INC.

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I. INTRODUCTION

VMSI's brief in response to HSC's appeal of the award of prevailing party fees and costs is chock-full of unsupported and, in fact, demonstrably inaccurate factual and legal assertions. Just a few of these are:

- That Fireman's Fund is not subrogating against HSC even though respondent does not deny that ***all*** the fees and costs awarded, if affirmed, will go to Fireman's Fund – not VMSI;
- That "this is not an insurance defense case" and that Fireman's Fund "never undertook to defend against HSC's cross-claims," when there is neither argument nor any evidence in the record that anyone other than Fireman's Fund undertook to defend VMSI on all claims asserted, including HSC's cross-claims;
- That HSC raised the anti-subrogation argument for the first time on reconsideration when, in fact, it was raised in response to VMSI's "renewed" motion for fees after VMSI's first motion was denied for failure to provide the very discovery supporting HSC's anti-subrogation argument;
- That both HSC and VMSI "agreed" that $250 per hour was a

reasonable rate for VMSI's attorneys when, in fact, HSC's position was only that the results obtained for HSC – the confidential settlement of the Widrig claims solely by VMSI's insurer with no contribution from HSC – warranted that rate for HSC's counsel, not VMSI's counsel;

- That the superior court's analysis of the requested hours was "thorough," when there is an abject absence of findings supporting the award; and, finally,
- A rather puzzling and scurrilous argument that HSC is making the "libelous" suggestion that VMSI's counsel and Fireman's Fund's counsel breached their duties of "undivided loyalty" to VMSI and Fireman's Fund, respectively, when HSC's briefing has never suggested any such thing, but, rather, that Fireman's Fund breached its duties to its additional insured, HSC.

In sum, as HSC stated in its opening brief, there are only two broad issues before the Court on HSC's second appeal. The first is the propriety of the superior court's award of any prevailing party fees and costs – ostensibly to VMSI – when the litigation was under the complete control of VMSI's insurer, Fireman's Fund, which sought, and seeks, subrogation against its additional insured on the same policy, HSC. The second issue,

which the Court need not reach if HSC prevails on the first issue, is whether the trial court abused its discretion in awarding $53,122.50 in prevailing party fees when there is a total lack of findings of fact in the record to support it.

VMSI's mischaracterizations of both the record and HSC's arguments do not change the nature of these two fundamental issues and, in fact, VMSI's response fails to squarely address them.

II. ARGUMENT

A. HSC's Challenge to VMSI's Right to Any Award of Fees and Costs is Properly Before the Court on Appeal.

Much like VMSI's response to HSC's first appeal in this matter, VMSI's first line of defense of the order on fees and costs is that HSC cannot appeal it, asserting that the issue of Fireman's Fund subrogating against its own insured is not properly before this Court on appeal because "HSC did not raise the issue of subrogation until after the trial court had ruled that VMSI was entitled to its fees." Resp., p. 5. It is simply disingenuous to make such an argument with the full knowledge that the evidence that Fireman's Fund was subrogating against its own insured was not available to HSC until VMSI filed its application for prevailing party fees and costs. This circumstance was fully briefed by HSC, and VMSI's

response asserting the issue was not preserved for appeal does not deny that fact. *Compare* HSC br. pp. 6-9, *with* Resp. br., pp. 14-15.

Regardless, appeal from a judgment "brings up for review all orders made in the action." *Van Buren v. Peterson*, 108 Wash. 697, 698, 185 P. 572 (1919). Indeed, as the Washington Supreme Court stated more recently, but still over twenty years ago with regard to RAP 2.4 and arguments similar to those asserted by VMSI, ". . . the Rules of Appellate Procedure were specifically designed to eliminate 'a trap for the unwary' which existed under the prior rules 'in that a failure to appeal an appealable order could prevent its review upon appeal from a final judgment.'" *Fox v. Sunmaster Prods, Inc.*, 115 Wn.2d 498, 505, 798 P.2d 808 (1990). Thus, VMSI's waiver argument is wholly without merit.

In addition, VMSI incorrectly asserts that HSC first raised the subrogation issue in a motion for reconsideration. Resp., p. 14, *citing* CP2 255-57.[1] The HSC briefing cited by VMSI is actually HSC's response and opposition to VMSI's renewed motion for an award of fees and costs, the one VMSI filed after the superior court denied its first motion and ordered

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[1] HSC agrees with VMSI that, with two appeals being consolidated, the use of "CP2" for the clerks papers on the second appeal may help avoid confusion and so adopts that system of citation here.

VMSI to provide previously requested discovery. *See* CP2 245-67. And, as is clear from that response, it was the evidence the court ordered VMSI to provide in discovery that revealed the subrogation issue. *See id.* Because HSC raised the issue in response to VMSI's renewed motion, VMSI was able to respond to it in its reply. *See* CP 350-59.

Moreover, even if HSC had raised the subrogation issue for the first time in a motion for reconsideration (which it did not), this Court has held that where the opposing party "had the opportunity to respond and the trial court entertained and decided the issue, RAP 2.5(a) is not a reason for us to deny review." *River Development, Inc. v. Integrus Architecture, P.S.*, 167 Wn. App. 221, 231, 272 P.3d 289 (2012); *see Schreiner Farms, Inc. v. American Tower, Inc.*, 173 Wn. App. 154, 293 P.3d 407 (2013) ("new issues may be raised for the first time in a motion for reconsideration, thereby preserving them for review, where . . . they are not dependent upon new facts and are closely related to and part of the original theory."), *quoting Nail v. Consol. Res. Health Care Fund I*, 155 Wn. App. 227, 232, 229 P.3d 885 (2010). Here, VMSI responded to HSC's anti-subrogation argument and the superior court addressed it on the merits. *See* CP2 358-59; CP2 431. So there is no reason for this

Court not to consider and address the argument.

In sum, as much as VMSI and Fireman's Fund would prefer that this Court not address the anti-subrogation issue, it is squarely and properly before this Court for resolution.

B. VMSI Mischaracterizes the Nature of the Claims to Avoid a Subrogation Analysis.

1. Contract claims can be subrogated.

VMSI baldly and incorrectly asserts that "HSC's [anti-] subrogation claim cannot be based on contract law." Resp., p. 13. This is fundamentally incorrect, as insurers obtain subrogation based on contractual rights of their insureds all the time. *See, e.g., Mutual of Enumclaw Ins. Co. v. Gregg's Roofing, Inc.*, 178 Wn. App. 702, 315 P.3d 1143 (2013) (insurance company subrogated to church's breach of contract claim against roofer); *Bird v. Best Plumbing Group, LLC*, 175 Wn.2d 756, 287 P.3d 551 (2012) (landowner's insurer brought subrogation action against contractor and then obtained covenant judgement to pursue contractor's insurer); *Affiliated FM Ins. Co. v. LTK Consulting Services, Inc.*, 170 Wn.2d 442, 243 P.3d 521 (2010) (insurer for Seattle monorail operator asserted subrogation claim against engineering firm allegedly responsible for fire); *Mutual of Enumclaw Ins. Co. v. USF Ins. Co.*, 164

Wn.2d 411, 191 P.3d 866 (2008) (holding two insurers for contractor that settled claims against contractor entitled to subrogation against non-settling insurer). So there is nothing special about contract claims when considering subrogation.

Similarly, VMSI's reliance on the *Mahler* case is misplaced. *See* Resp., p. 13, *citing Mahler v. Szucs*, 135 Wn.2d 398, 413, 957 P.2d 632 (1998). The *Mahler* case was a tort case, so there is nothing surprising about its reference to tort claims, nor is there anything inimical to contracts in its discussion concerning an insurer's ability to obtain subrogation "by an action by the subrogee/insurer in the name of the insured against the tortfeasor" or by "a type of lien against the subrogor/insured's recovery from a tortfeasor." *Mahler*, 135 Wn.2d at 417-18. Here, Fireman's Fund defended VMSI for both the Widrig claims and HSC's cross-claim and eventually negotiated a confidential settlement of the Widrig claims releasing both its insureds. Thus, it has a lien on any recovery by VMSI against HSC for all of its defense and indemnity payments, if any, in the case. It's that simple, and subrogation of one insured's claim against another insured on the same policy in order to obtain reimbursement for the same insured loss is plainly not allowed under Washington law. *See, e.g., Mahler*, 135 Wn.2d at 419 ("No right of subrogation can arise in

favor of an insurer against its own insured since, by definition, subrogation exists only with respect to rights of the insurer against third parties to whom the insurer owes no duty."), *quoting Stetina v. State Farm Mut. Auto. Ins. Co.*, 196 Neb. 441, 243 N.W.2d 341, 346 (1976), *and* 16 GEORGE J. COUCH, INSURANCE, § 61:136, at 195-96, (2d Ed. 1983); *see Community Ass'n Underwriters of Am., Inc. v. Kalles*, 146 Wn. App. 30, 259 P.3d 1154 (2011) (same).

2. Even if recovery of a portion of Fireman's Fund's fees and expenses actually incurred in defense of the cross-claims were allowable, the judgment still reflects improper subrogation of over $47,000.

VMSI also argues that the cross-claims were a contract dispute between the two insureds that were not insured by Fireman's Fund and so not a matter of subrogation. Resp., p. 13. As discussed above, this is incorrect. However, even if VMSI's argument had merit, under that same rationale, the judgment against HSC in excess of what Fireman's Fund actually paid in defense of the cross-claims is still undeniably subrogation of defense and indemnity of the Widrig claims – the common insured loss on the policy on which both parties are insureds.

Fireman's Fund paid a contracted $14,688 in defense fees plus whatever it took to obtain the confidential settlement of the Widrig claims,

on which she originally demanded some $7 million. CP2 22-23, ¶¶ 2-3. As already demonstrated in the record, the percentage share of the $14,688 reasonably allocable to defense of HSC's cross-claims is quite small. Even if one assumes, *arguendo*, that the superior court's conclusion that 236.1 hours in defense of the cross-claims was reasonable for defense of the cross-claims, that is only 35% of the total 674.1 hours billed. *See* CP2 52 (total 568.1 hours through first motion for fees); CP2 241 (additional 106 hours on second motion for fees). Thirty-five percent of $14,688 is $5,140.80. *Cf. Ledcor v. Mutual of Enumclaw,* 150 Wn. App. 1, 206 P.3d 1255 (2009) (approving a percentage allocation in a construction defect case).

So, even if this Court were to accept VMSI's argument that defense of the cross-claims is not something on which HSC was insured and subrogation is not precluded, the fact still remains that recovery of anything over $5,140.80 is subrogation by Fireman's Fund of the common defense of the Widrig claims and anything Fireman's Fund paid in settlement. Thus, even were this Court to accept VMSI's superficial argument that the cross-claims were not an insured risk or loss and not subject to the anti-subrogation rules, then, of the total award of $53,122.50, approximately $47,981.70 is improper subrogation of defense

and indemnity of the Widrig claims for which it is undisputed HSC was insured on the Fireman's Fund policy issued to VMSI.

VMSI's argument that the claim for fees is not subrogation because "[t]he real party causing the loss was Cody Kloepper," is similarly misplaced. Resp., p. 13. The allegations of the Widrig complaint were that HSC was responsible for negligent hiring and supervision of Mr. Kloepper[2] and that VMSI was responsible for HSC's negligence under agency principles. *See* CP 1-3. While both parties took the position on summary judgment that they were not responsible for the intentional criminal acts of Mr. Kloepper, those motions were denied by the trial court. So, Fireman's Fund did ***not*** settle the Widrig claims based on Mr. Kloepper's liability, but on the potential for liability against its two insureds, VMSI and HSC. It is now trying to collect money back from one of those insureds, HSC, and most, if not all, of that money is far in excess of any fees and costs incurred by Fireman's Fund in the defense of HSC's cross-claims. Thus, the recovery of that excess, at the very least, is improper subrogation by Fireman's Fund against its own insured in violation of Washington law.

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[2] Mr. Kloepper was not a party to the civil action brought by Ms. Widrig.

C. Fireman's Fund Controlled the Litigation for VMSI.

While it does not warrant a lengthy response, VMSI's shrill accusations of "libelous" assertions in HSC's briefing require a brief rebuttal. *See* Resp., p. 16-17. First, there being no known conflict between Fireman's Fund and VMSI, HSC asserted no such conflict and asserts no breach of the respective counsels' duties of "undivided loyalty" to their respective clients. That claim by VMSI is plain silly. Second, VMSI points to nothing in the record leading to any reasonable inference that Fireman's Fund did not control the litigation for VMSI, the indignant denials in VMSI's briefing notwithstanding. *See Strandberg v. Northern Pac. Ry. Co.*, 59 Wash. 259, 265, 367 P.2d 137 (1961) (holding argument of counsel is not evidence).

It should be no surprise to this Court that an insurance company exercises control over the defense of its insured when there is no reservation of rights[3], as the terms of most policies of liability insurance give them the right, as well as the duty, to defend. *See Peterson-Gonzalez v. Garcia*, 120 Wn. App. 624, 86 P.3d 210 (2004) (holding "right to defend" clause in insurance policy gave UIM insurer right to participate at

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[3] Fireman's Fund's reservation of rights on the defense of HSC was not withdrawn until September 26, 2012. *See* CP 66.

trial); *see also, Swanson v. State Farm Gen'l Ins. Co.*, 219 Cal.App.4th 1153, 162 Cal.Rptr.3d 477, 483 (2013) (insurer "has right to control defense and settlement of the third party action against its insured."); *Sherwood Brands, Inc. v. Hartford Acc. and Indem. Co.*, 347 Md. 32, 698 AD.2d 1078, 1083 (1997) ("It is common – almost universal – for liability policies to give the insurer both the *right* to control the defense of any claim covered by the policy and the *duty* to provide that defense.") (emphasis original), *citing* 14 COUCH ON INSURANCE 2d, §51.35 at 438 (Rev. Ed. 1982 & Supp. 1996); *Desriusseaux v. Val-Roc Truck Corp.*, 230 AD.2d 704, 705, 646 N.Y.S.2d 161 (1996) ("Generally, absent a showing that there is a conflict of interest between a liability insurer and the insured, an insurer has the right to control the defense of an action brought against the insured.").

The real issue here is not that Fireman's Fund controlled VMSI's defense, but that it did so in an improper effort against its co-insured on the policy, HSC. That fact does nothing to impugn the integrity of VMSI's counsel, who had no conflict between representing his client and his carrier and owed no duty of loyalty to HSC, nor did HSC express, suggest, or intend to suggest otherwise.

Use of the defense of one insured against another by Fireman's

Fund is nothing new, as counsel for HSC had contemporaneous experience with Fireman's Fund and its hand in, at the very least, influencing in bad faith a co-defendant insured's response to a tender of contractual defense and indemnity and the named insured's defense of cross-claims in a similar case. *See e.g., Seaway Properties, LLC v. Fireman's Fund Ins. Co.*, No. C13-633RAJ, – F.Supp.2d –, 2014 WL 1612696 (W.D.Wash., April 22, 2014). In the *Seaway* case the additional insured tendered to both Fireman's Fund and the named insured and, like here, Fireman's Fund delayed responding for months before presenting a response coordinated with appointed counsel for its named insured co-defendant. *See id.* Fireman's Fund's coverage counsel in *Seaway* was the same attorney at Cozen O'Connor who provided coverage analysis here, and the coverage issues in both cases were being disputed during the same time frame of 2012 and early 2013. *See id.* Similarly, the attorney appointed by Fireman's Fund to defend the restaurant, Ciao Bella, in the *Seaway* case was the same attorney Fireman's Fund appointed to defend HSC under a reservation of rights that was later withdrawn.[4] Ultimately, the federal

[4] While it was not a conflict for the attorney appointed by Fireman's Fund to serve as opposing counsel in *Seaway* and co-defense counsel to HSC at the same time, Fireman's Fund created, intentionally or not, a very awkward situation among HSC's defense team.

district court in Seaway ruled that the delay alone in responding to Seaway's tender violated Washington's Insurance Fair Conduct Act and the Consumer Protection Act. *See id.*

In this case, even though Fireman's Fund eventually accepted HSC's tender, albeit under a reservation of rights that was ultimately dropped, and even though it said it would pay a portion of HSC's fees and costs[5], Fireman's Fund never contributed one dime to HSC's defense. *See* CP2 372-73, ¶ 9. Furthermore, Fireman's Fund undeniably worked with counsel for VMSI on the defense of HSC cross-claims – activities which ultimately were another means to the end of having Fireman's Fund avoid reimbursement of HSC's defense fees and costs, since, under the parties' management agreement, VMSI is not ultimately responsible for indemnifying HSC beyond the coverage afforded by its insurance obtained from, among others, Fireman's Fund. CP2 103, ¶ 11.

D. The Award of Fees and Costs was an Abuse of Discretion.

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[5] The duty to defend arises when a complaint against the insured, construed liberally, alleges facts which could, if proven, impose liability upon the insured within the policy's coverage. *Am. Best Food, Inc. v. Alea London, Ltd.,* 168 Wn.2d 398, 404-05, 229 P.3d 693 (2010). Furthermore, "[T]he mere offer to participate [in the defense] on a pro rata basis, without further action, does not equate to providing a defense or otherwise cure the breach of the duty to defend." *Newmont USA v. Am. Home Assurance,* 675 F.Supp.2d 1146, 1161-62 (E.D. Wash. 2009) and *see also National Surety Corp. V. Immunex Corp.,* 176 Wn.2d 872, 297 P.3d 688 (2013)(holding that when an insurer undertakes to defend its insured under a reservation of rights, it must pay defense costs until it obtains a judicial declaration that it owes no duty to defend).

VMSI does not deny that it failed to submit a lodestar for its fees and does not present any argument in response to HSC's challenge to the adequacy of the superior court's findings of fact in support of the award of fees and costs.

1. Lack of any lodestar analysis leads to an arbitrary award.

VMSI asserts that, although it did not submit a lodestar calculation for its fees, HSC did; so VMSI can just use HSC's counsel's lodestar, since "[t]here is no significant distinction between the skill and experience of the attorneys other than the success of VMSI's in this matter." Resp., p. 12. VMSI wholly misrepresents the lodestar analysis. Typically, it starts with counsel's actual hourly rate, if found reasonable. And then it proceeds with a simple formula of multiplying counsel's reasonable hourly rate by the reasonable number of hours expended. *Mahler*, 135 Wn.2d at 434. Fundamentally, HSC's lodestar is not VMSI's lodestar because VMSI has never billed $168 per hour for this case.

For the initial rate, prior to application of any multiplier, the "court must also determine the reasonableness of the hourly rate of counsel at the time the lawyer actually billed the client for the services." *Mahler*, 135 Wn.2d at 434, *citing Fisher Properties, Inc. V. Arden-Mayfair, Inc.*, 115 Wn.2d 364, 798 P.2d 799 (1990) (outside civil rights context,

contemporaneous rates actually billed rather than current rates or contemporaneous rates adjusted for inflation will be employed). Here, HSC's counsel provided his rate of $168 per hour along with additional information to justify a multiplier on that rate, including the significant fact that through counsel's efforts, VMSI's insurer, Fireman's Fund, effected a settlement of plaintiff's multi-million dollar claims with no contribution from HSC. CP 91-93. That, regardless of the ultimate outcome of the cross-claims, was an excellent result. And no one contends otherwise.

Conversely, VMSI's counsel did not provide any hourly rate to the trial court, instead pointing to HSC's requested multiplier to $250 per hour as a reasonable rate, and could only point to dismissal of the cross-claim after a year and a half of litigation as some degree of success. CP2 154 & 240-41. VMSI's counsel's attempts to get out of the case on summary judgment failed, as the superior court granted plaintiff's motion for partial summary judgment against VMSI on the issue of agency, and the retaining insurer, Fireman's Fund, effected the settlement of plaintiff's claims and agreed to pay defense fees and costs for both defendants (though it never did pay anything for HSC's defense). *See* CP2 372-73, ¶ 9.

Rather than use any kind of lodestar analysis, VMSI skipped that

step entirely, moving straight to the multiplier fee rate requested by HSC's counsel, apparently on the assumption that if HSC's counsel should receive a multiplier for winning, then VMSI's counsel should receive some sort of multiplier to the same requested rate if he won. CP2 240-41.

Given the confused and confusing nature of VMSI's submission, it should, perhaps, not be too surprising that the superior court also missed some steps, failing to conduct its own lodestar analysis and arbitrarily picking a fee rate that was higher than VMSI's counsel's lodestar rate even though the court concluded, "VMSI has not presented evidence to establish that this was a particularly difficult or complicated case to defend by VMSI" and made no reference to any multiplier on the lodestar rate. CP 416. In the end, the lack of any lodestar analysis by VMSI or the superior court leaves little basis in the record to support the court's award. *See Highland School Dist. No. 203 v. Racy*, 149 Wn. App. 307, 202 P.3d 1024 (2009) ("A trial judge who strays from this formula will typically have a difficult time establishing that an award of attorneys' fees is actually reasonable.") (Korsmo, J.) And absent a factual basis in the record, the award must be reversed.

2. <u>VMSI does not dispute HSC's challenge to the sufficiency of the findings of fact in support of the award of fees and costs</u>.

VMSI goes to great pains attempting to distinguish the facts and circumstance of the *Berryman* case from those at issue in this case. *See* Resp., pp. 7-9, *citing Berryman v. Metcalf*, 177 Wn. App. 644, 312 P.3d 745 (2013). But HSC did not cite *Berryman* for the many problems with the plaintiff's fee request in that case, but for what a trial court needs to do when ruling on such a request. *See* HSC br., pp. 26-27. And it is that very issue that VMSI utterly fails to address – "The findings must show how the court resolved disputed issues of fact and the conclusions must explain the court's analysis." *Berryman*, 177 Wn. App. at 658. Indeed, VMSI never discusses the adequacy of the court's findings of fact or conclusions of law. *See* Resp., pp. 7-12. Therefore, since VMSI has submitted nothing for HSC to reply to on this issue, HSC relies on the discussion in its opening brief regarding the insufficiency of the superior court's findings of fact. *See* HSC br., pp. 21-28.

III. CONCLUSION

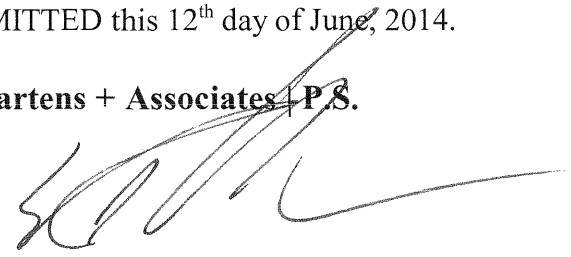
VMSI's response to HSC's appeal of the award of prevailing party fees and costs in this case fails to establish that Fireman's Fund is not improperly subrogating against HSC, relying instead on a litany of mischaracterizations of the issues on this appeal and HSC's arguments. Undeniably, subrogation by an insurance carrier against one of its insureds

on the policy is simply not allowed. Further, even if subrogation was somehow proper, VMSI entirely ignores the fundamental lack of supporting findings of fact and conclusions of law in the trial court's order, effectively conceding the merit of HSC's position.

Accordingly, to the extent appeal of the judgment is not rendered moot by this Court's resolution of the appeal of the order on summary judgment, this honorable Court should reverse the judgment entered against HSC.

RESPECTFULLY SUBMITTED this 12th day of June, 2014.

Martens + Associates, P.S.



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CERTIFICATE OF SERVICE

I certify that on the day and date indicated below, I caused the foregoing to be filed with the court and served on behalf of Appellant HSC Real Estate, Inc., on the following counsel as indicated below:

Counsel for Respondent VMSI, LLC William A. Cameron, Esq. Lee Smart P.S. 1800 One Convention Place 701 Pike Street Seattle, Washington 98101-3929	☐ U.S. Mail ☐ Telefax ☑ Hand Delivery ☐ Overnight Delivery ☐ E-mail with Recipient's Approval

I declare under the penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

SIGNED THIS 12th day of June 2014 at Seattle, Washington.

Sarah Smith
Paralegal for Martens + Associates | P.S.