No. 94118-1

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON
(Court of Appeals No. 34022-8-III)

INLAND EMPIRE DRY WALL SUPPLY CO.,

Respondent,

v.

WESTERN SURETY CO.,

Petitioner.

INLAND EMPIRE DRY WALL SUPPLY CO.'S ANSWER TO PETITION FOR REVIEW

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I. IDENTITY OF RESPONDENT

Inland Empire Dry Wall Supply, Co., ("Inland"), Respondent below, offers this Answer to Petitioner Western Surety Co.'s ("Western") Petition for Review.

II. INTRODUCTION

> "*By the plain terms of RCW 60.04.161, Inland was only required to name Western, as the bond surety, as a defendant to its bond foreclosure action.*"[1]

This case involves the question of who is a necessary party when a lien release bond issued pursuant to RCW 60.04.161 has released property from a lien, e.g. "*who must be served when a bond releases a piece of property?*"

This matter arose after Inland filed suit against Western, as the bond surety, to recover moneys owed for materials it delivered to a commercial construction project.

Inland filed a motion for summary judgment on its lien foreclosure claim and Western filed a cross-motion for summary judgment seeking to dismiss the case, alleging Inland failed to properly file suit against Fowler General Construction ("Fowler"), the principal on the lien bond. Thereafter,

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[1] Inland Empire Dry Wall Supply Co. v. Western Surety Company, 2017 WL 89138, *5 (Div. III, 2017).

the trial court granted Western's cross-motion for summary judgment and Inland appealed.

In reversing the trial court, Division III correctly relied upon statutory construction and general suretyship principles in holding Inland was "*only required to name Western, as the bond surety, as a defendant to its bond foreclosure action.*" Inland Empire Dry Wall Supply Co. v. Western Surety Company, 2017 WL 89138, *5 (Div. III, 2017). The appellate court did not err in doing so.

III. STATEMENT OF THE CASE

Inland is a supplier of drywall materials for use on construction projects. CP 4, 10. On or about October 15, 2012, Inland entered into a credit agreement to sell drywall materials to Eastern Washington Drywall & Paint, LLC ("EWD&P"). CP 4, 11, 14-15.

Thereafter, EWD&P entered into a subcontract with Fowler, the general contractor on the Bella Vista Apartments in Richland, Washington ("Project"). CP 4, 10, 25.

On April 14, 2014, EWD&P placed its first of many orders of materials from Inland for the Project. CP 11, 16-17. In total, Inland supplied $124,653.05 worth of drywall to EWD&P. CP 11, 16-17. EWD&P admits it did not pay Inland the $124,653.05 owed. CP 11, 25-26.

Inland timely and properly, as required by RCW 60.04.031, served a pre-claim lien notice to the Project's owner, Western States Development Corporation. CP 11, 18-20.

On September 26, 2014, Inland timely and properly, as required by RCW 60.04.091, recorded a lien in Benton County, Washington under Auditor's number 2014-024259. CP 11, 21-22.

On November 17, 2014, Fowler, the general contractor, pursuant to RCW 60.04.161, recorded a release of lien bond, issued by Western, in the Benton County Auditor's Office in the amount of $186,979.57 to release the Project from Inland's lien. CP 49-50.

On January 5, 2015, Inland timely filed its summons and complaint to foreclose on its lien. RCW 60.04.141. CP 1-6.

On October 2, 2015, the trial court heard oral argument on cross-motions for summary judgment. CP 118-120.

On October 6, 2015, the trial court sent a letter to Inland and Western announcing it was granting Western's motion for summary judgment and denying Inland's motion for summary judgment. CP 118-120. The trial court concluded that RCW 60.04.141 requires a lien claimant name the "*owner of the subject property*" in the lawsuit and that the release of lien bond was now the "*subject property*." CP 120. The trial court then erroneously reasoned

that both the principal and surety were the "*owners of the subject property*" thus concluding a lien claimant must name both in the lawsuit. CP 120.

On October 29, 2015, Inland timely filed a motion for reconsideration. CP 124-125, 126-134.

On December 16, 2015, the trial court entered the order denying Inland's motion for reconsideration. CP 153-154. Inland initiated a timely appeal. CP 155-157.

On January 10, 2017, the Court of Appeals, Division III, filed its published opinion reversing the trial court's grant of summary judgment and remanded the matter to the trial court. In doing so, the majority, in reliance upon a plain reading of RCW 60.04.161 and general suretyship principles, correctly held Inland, the lienholder, "*was only required to name [Western], as the bond surety, as defendant to its action.*" Inland, supra, at *5.

IV. ARGUMENT

A. No Conflict Exists Between Division III's Inland Empire Holding Addressing Whether A Release Of Lien Bond Principal Is A Necessary Party And Division II's CalPortland Holding Addressing Whether A Property Owner Must Be Named As A Necessary Party After Bond Is Posted.

Western's assertion that both Inland Empire Dry Wall Supply Co. v. W. Sur. Co., 2017 WL 89138 (Div. III, 2017) and CalPortland Co. v. LevelOne Concrete, LLC, 180 Wn. App. 379 (Div. II, 2014) addressed "*who*

must a construction lien claimant timely sue and serve with a lien enforcement action under RCW 60.04.141 when a lien release bond is recorded under RCW 60.04.161 before commencement of the action," is patently incorrect. Pet., p. 7. CalPortland addressed the question of whether a lien claimant must sue and serve a property owner after a lien release bond is recorded under RCW 60.04.161; while Inland addressed whether a lien claimant must sue and serve both the principal and the surety after a lien release bond is recorded under RCW 60.04.161.

Given the substantive differences between the questions addressed, there is no feasible way the respective holdings can or did create conflict.

Division II's opinion in CalPortland held that service of process on the surety and principal was sufficient to comply with the requirements of RCW 60.04.141, not that service on both was necessary to comply with the statute. Notably, CalPortland did not address the question of whether **both** the principal and surety are **necessary parties** to a lien foreclosure lawsuit when a lien release bond is in place. Indeed, prior to the Inland decision, no Washington State appellate court has ever addressed that question.

Contrary to Western's erroneous assertions, CalPortland, never:

- **Addressed or decided** "*who, [] was/is a necessary party to a lien enforcement action against a release bond for purposes of complying with RCW 60.04.141.*" Pet., p. 9.

- **Determined** "*that the named principal and surety under the bond were 'the only parties with an interest in the bond...' and the parties having an 'ownership interest' in 'property subject to the lien' for purposes of RCW 60.04.141's procedural requirements....*" Pet., p. 9.

- **Implied or concluded** "*a lien claimant must also timely sue, serve, and obtain judgment against the named principal under a release bond establishing the lien's correctness and validity as conditions precedent to the claimant seeking and obtaining payment from the surety and bond.*" Pet., p. 9-10.

- **Expressly held** "*it was service of process on both the named surety and principal under a release bond that constituted sufficient compliance with RCW 60.04.141's procedural requirements.*" Pet., p. 11.

- **Determined** "*both the named surety and principal under a release bond have an 'ownership interest' in 'property subject to the lien' (i.e., the release bond) for purposes of RCW 60.04.141's procedural requirements.*" Pet., p. 11.

Rather, CalPortland simply held "*[b]ecause a bond in lieu of claim had already been recorded, the plain meaning of the statutory language did not require CalPortland to serve Costco* [the property owner]." Supra at 391.

As stated by Division III: "*All we said in CalPortland was that a suit against both a bond principal and bond surety is sufficient for compliance with the lien release bond statute. The ruling did not address whether suit against both is necessary.*" Inland, supra, at *2. Indeed, nothing within CalPortland addresses the entirely different issue addressed by Division III: whether a principal on a release of lien bond is a necessary party to a lawsuit

against the bond. Therefore, no conflict exists between Division III and Division II warranting this Court's review.

B. The Long-Standing General Suretyship Principle That A Claimant May Seek Relief Only Against A Surety Was Correctly Recognized By Division III.

This case stands for a very simple, long-held legal principle: "*The general suretyship principle that a claimant may seek relief only against a surety....*" See Inland, supra, at *5. Division III's decision in Inland correctly recognizes and applies this principle in rendering the decision at issue. Contrary to Western's assertion, Division III's reliance upon this long-standing suretyship principle does not "*ignore*" or "*subvert*" RCW 60.04.161's intent and purpose.

Additionally, Western's argument conflates "*interested party*" with "*necessary party*," e.g., an indispensable party pursuant to CR 19. In determining who is a necessary party under Washington law, the test is whether a "*person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (A) as a practical matter impair or impede the person's ability to protect that interest....*" See CR 19(a)(2)(A) (emphasis added).

Western incorrectly argues that because the principal purchased a lien release bond, it is a necessary party to the underlying lien foreclosure lawsuit.

Notably, there is no statutory requisite in place mandating a principal "*must be made a party*" in every bond foreclosure action. To the contrary, well-established law holds that a surety alone may be sued without joinder of the principal. RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 50 cmt. a, §50(1); Hutnick v. U.S. Fid. and Guar. Co., 47 Cal.3d 456, 468–69 (1988); and Warren v. Washington Trust Bank, 92 Wn.2d 381, 390 n.1 (1979). Here, RCW 60.04.161 is consistent with the common law. To that point RCW 60.04.161 specifically addresses only the surety ("*[I]f no action is commenced [within the time frame set by RCW 60.04.141], the surety shall be discharged from liability.*"). Inland, supra, at *3.

While a principal is liable under a bond to indemnify (repay) the surety for any amounts paid from the bond, this does not mean the principal is a "*necessary/indispensable party*" in litigating the validity of the lien and the right to payment from the bond. Indeed, RCW 60.04.161 makes clear "***any owner** of real property subject to a recorded claim of lien..., or **contractor, subcontractor, lender, or lien claimant** who disputes the correctness or validity of the claim of lien may record... a bond issued by a surety company authorized to issue surety bonds in the state.*" RCW 60.04.161 (emphasis added).

Moreover, Western's argument ignores the purpose of RCW 60.04.161 which is "*to allow a party to file a bond to support transferring to the bond a lien against the property* ***to allow the party supplying the bond to free up the property for conveyance.***" CalPortland, supra, at 386-387 (emphasis added). "*A lien bond releases the property from the lien, but the lien is then secured by the bond.*" DBM Consulting Engineers, Inc. v. U.S. Fid. & Guar. Co., 142 Wn. App. 35, 42 (Div. I., 2007). "*In like manner, application of the bond statute operates to substitute the bond surety for the property owner as the individual that must be sued in a timely manner.*" Inland at *4.

Western's conclusory assertion that every principal who records a bond "*must be made a party to* [a bond enforcement] *action*" is simply false. See Pet., p. 15. The statute allows a number of entities to record a bond, even an "*interested party*," such as a lender who may wish to clear a cloud [the lien] or title to real property. Notably, a lender, while indisputably an interested party in litigation regarding the correctness and validity of the underlying lien, will not necessarily be an indispensable party.

Western's position could lead to ludicrous results. Assume the owner pays the general who has a fight with the subcontractor, and the owner posts the lien release bond in order to avoid involvement in a lawsuit.

Alternatively, assume a third party purchases property that requires a release of lien bond to be posted to clear title. Under Western's scenario, the owner or the innocent purchaser would have no choice but to incur unnecessary costs in defending against suit.

Conversely, general suretyship principles make clear a bond lien claimant "*'has two sets of rights, one set against the principal obligor and the other against the secondary obligor,' also known as the surety.*" Inland, supra, at *4. See also Warren v. Washington Trust Bank, 92 Wn.2d 381, 390 n. 1 (1979) ("*it is the general rule that, even though the creditor has a security interest in property of the principal, he may proceed first against the surety before resorting to the security interest*").

Finally, Western's allegation that Division III's holding will allow a claimant to "*side-step and strategically avoid litigating a disputed lien*" is baseless. Regardless of whether or not the claimant files against the surety or both the principal and the surety, the claimant still carries the burden of proof in litigating the correctness or validity of the underlying lien in order to recover.

The only public policy implication of this case is the long-established, general suretyship principle that a claimant may seek relief only against a

surety. See Inland, supra, at *5. Accordingly, Division III correctly held the surety, Western, was the only necessary party to the suit.

C. Western Has Impermissibly Stretched The Plain Meaning Of RCW 60.04.161, Attempting To Create Statutory Rights Where None Exist.

1. Lien Claimants Are Not Mandated To Sue The Principal Whenever A Lien Release Bond Has Been Recorded.

Western argues that RCW 60.04.161 creates a new right in favor of any principal who posts a bond and a corollary obligation of every lien claimant to sue the entity who records a bond. See Pet., pp. 15-17. Western's argument is based entirely upon a strained manipulation of the second line of RCW 60.04.161, which provides in part:

> "*Any owner of real property subject to a recorded claim of lien... or contractor, subcontractor, lender, or lien claimant who disputes the correctness or validity of the claim of lien may record*"

RCW 60.04.161. Notably, Division II rejected Western's argument two years prior to its 2014 decision in CalPortland. See Olson Eng'g, Inc. v. KeyBank Nat. Ass'n, 171 Wn. App. 57 (2012).

In Olson, Olson Engineering had performed surveying, engineering, and general planning services at the request of parties who did not yet have title to the property. Later, one of the requesting parties did obtain title to the property. Olson Engineering, who was not fully paid, filed a claim of lien on the property and initiated a lien foreclosure action. The defendant, KeyBank,

as the foreclosing bank, held a mortgage on the property and recorded a lien release bond in order to foreclose. KeyBank argued RCW 60.04.161 did not prevent the court from adjudicating the parties' lien priorities when one party files a release of lien bond. Division II agreed with KeyBank, holding Olson Engineering's lien was not valid to the extent that it included work performed prior to when the company took title to the property. Division II in Olson stated:

> "*We agree with KeyBank, however, that* ***the plain language*** *of the following sentence* ***merely qualifies who may file a release-of-lien bond and that it does not limit the scope of the parties' lien priority dispute****: Any... lender... who disputes the correctness or validity of the claim of lien may record... a bond issued by a surety company authorized to issue surety bonds in the state.*"

Olson, supra, at 67-68 (emphasis added).

Here, Western's argument that RCW 60.04.161 creates an entire set of rights and obligations is meritless, since contrary to Western's claim, CalPortland does not support this novel contention. Moreover, nothing in RCW 60.04.161 creates a "right" entitling any member of a class of entities statutorily permitted to record a release of lien bond to automatically become a necessary party to a lien foreclosure lawsuit. Indeed, such "right" would effectively subvert the actual multiple contract rights at issue and adversely affect other procedural rules governing lien foreclosure.

Moreover, in order to support its strained conclusions, Western adopts circular reasoning and inserts words into both RCW 60.04.161 and relevant case law. Western's assertions reveal its complete disconnect with the plain language of RCW 60.04.161 as well as the well-established law of surety and principal. For example, nothing in the statute or common law of surety and principal requires Inland to (1) obtain a judgment against the principal [Fowler] or (2) first demand that the principal [Fowler] satisfy any judgment against the surety. See Pet., pp. 10 and 16.

Western's reliance on the cases of DBM Consulting Engineers and Stonewood Design in support of the erroneous conclusion that a lien claimant must "*successfully litigate*" with and obtain a judgment against the principal prior to acting against the surety, is seriously misplaced. See Pet., pp. 10 and 16; see also DBM Consulting Engineers, Inc. v. U.S. Fid. & Guar. Co., 142 Wn. App. 35, (Div. I, 2007) and Stonewood Design, Inc. v. Heritage Homes, Inc., 165 Wn. App. 720, 724 (2011).

In DBM Consulting Engineers, DBM filed a mechanics' lien against property for services rendered thereon. The owner recorded a release of lien bond from Travelers in order to clear title and sell the property. DBM obtained a judgment against the owner for breach of contract but did not pursue its claim for foreclosure of its lien. Instead, DBM filed a second

lawsuit against Travelers, seeking payment on the bond. The trial court entered summary judgment against Travelers. Division I reversed the trial court and held that "*in order to be entitled to payment on the bond, DBM needed to foreclose its lien.*" DBM Consulting Engineers, supra, at 42. At no point in its analysis did Division I address whether litigation against the principal was mandatory when litigating to foreclose a lien. Id.

Likewise, reliance on Stonewood does not support Western. In Stonewood, Division I did not address whether a lien claimant was required to sue the principal when litigating the validity of a lien against a surety. Rather, Stonewood addressed whether a claimant is required to utilize specific vocabulary, e.g., "*lien foreclosure,*" in litigating the validity of a lien. Division I concluded doing so would inappropriately "*elevate[] form over substance and misreads DBM, which requires that the validity of the mechanics' lien be litigated before execution on the release of lien bond is appropriate. DBM does not impose vocabulary requirements for judgments.*" Stonewood, supra, at 725.

Here, Inland sued the surety, Western, seeking foreclosure of its lien. CP 1-6. The question addressed by Division III was whether Inland was required to seek foreclosure of its lien against both the principal and the surety. In answering that question, Division III stated: "*as we explained [in*

CalPortland], *because a bond operates to release real property from being encumbered by a lien, once the bond is recorded, the real property owner is no longer an interested party. Instead, the bond replaces the property and suit is sufficient so long as it is against the bond.* CalPortland, *180 Wash. App. at 387-388, 321 P. 3d 1261.*" Inland, supra, at *2.

It is indisputable that RCW 60.04.161 allows a bond to be recorded, thus removing the construction lien from real property. The bond must be conditioned "*to guarantee payment of* ***any judgment upon the lien*** *in favor of the lien claimant entered* ***in any action to recover the amount claimed in a claim of lien*** *or on* ***the claim asserted in the claim of lien***". RCW 60.04.161 (emphasis added). Nothing in this statute, or any other provision of RCW 60.04, et. seq., even refers to the word "principal." Western has invented its entire argument without any support.

Likewise, "*once a lien release bond is recorded, the procedural statute shifts from RCW 60.04.141 to RCW 60.04.161.*" Id. at *3. "*Unlike RCW 60.04.141, RCW 60.04.161 makes no mention of the 'owner of subject property' as an entity necessarily impacted by a suit.*" Id. Nor does it mention "principal." "*Instead, the statute states it is the "surety" who must be included in a suit in a timely manner*," or the "*surety*" shall be discharged. Id.

Indeed, as asserted by Division III, if the legislature had intended RCW 60.04.141 to apply to the lien release bond context, it would not have specifically limited the applicability of RCW 60.04.141 to issues of timing. Id. at *4. In other words, the legislature could have easily stated: "... *if no action is commenced to recover on a lien with the time* [**and manner**] *specified in RCW 60.04.141, the surety* [**and principal**] *shall be discharged from liability under the bond.*" See RCW 60.04.161 (emphasis added). Clearly, our legislature was concerned only with the surety in the context of a bond foreclosure action. Id. at *5.

Finally, Western's strained interpretation of lien law would lead to absurd results. For example, assume that a subcontractor under contract with a general contractor files a lien against an owner's property. No release of lien bond is recorded. To perfect the subcontractor's construction lien, the subcontractor is not required to name the general contractor as a necessary party – only the property owner.

> "*No lien created by this chapter binds the property subject to the lien for a longer period than eight calendar months after the claim of lien has been recorded unless an action is filed by the lien claimant within that time... **and service is made upon the owner of the subject property***...."

RCW 60.04.141 (emphasis added); see also Diversified Wood Recycling, Inc. v. Johnson, 161 Wn. App. 891, 902 (Div. I, 2011). Under the above scenario,

the general contractor would be required to seek permission to intervene in the action. As a practical matter, this scenario happens frequently.

Now assume the general contractor in the above scenario posts a release of retainage bond. It is a disconnect to then suggest that RCW 60.04.161 somehow completely changes the rights and obligations of lien foreclosure by mandating the subcontractor sue the general contractor simply by virtue of the general contractor recording a lien release bond.

There is no language within RCW 60.04.161, or otherwise, to suggest that the legislature even remotely intended this result, much less intended to create an obligation on a lien claimant which does not appear in any statutory provision. See RCW 60.04, et. seq.

2. Contract Law Governs The Rights And Obligations Of Sureties And Principals.

In Western's attempts to create and utilize an unsupportable technical defense to avoid its contractual obligation as the surety to tender funds to a successful lien claimant, it ignores the reality of the construction industry. It is factually and legally indisputable that contract law governs the rights and obligations of all of the parties at issue.

For example, indemnity agreements govern the surety-principal relationship. Indemnity agreements provide that the principal will indemnify the surety in the event the surety is required to pay on a claim against the

bond. Under the great weight of authority, the claimant may sue the surety without naming the principal as a necessary party. Accordingly, contrary to Western's unsupported contentions, the claimant is not required to obtain a judgment against the principal to recover against the surety. See Pet., p. 15; see also Inland, supra, at *4, citing RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 50 cmt. a, §50(1); Hutnick v. U.S. Fid. and Guar. Co., 47 Cal.3d 456, 468–69 (1988) (service on surety sufficient to allow claim against mechanic's lien bond); and Warren v. Washington Trust Bank, 92 Wn.2d 381, 390 n.1 (1979) ("*it is the general rule that, even though the creditor has a security interest in property of the principal, he may proceed first against the surety before resorting to the security interest*").

While Western ignores these cases and claims a gross injustice would occur if the lien claimant were not statutorily required to sue the principal, this issue has consistently been present in every case involving a surety bond.

Moreover, as a practical matter, the surety is contractually required to provide notice to the principal and, in virtually every claim against the surety bond, does so and tenders the defenses of the bond claim to the principal. The principal steps into the shoes of the surety and defends the claim, just as is occurring in the present case. CP 86-87. In every other case, the unnamed party must seek to intervene, and due to the contractual rights and obligations

flowing between the owner, general contractor, and subcontractor, the interests of the parties are fully protected. The interested parties are either present or intervene as a matter of right.

This is how the industry has worked ever since the principal-surety relationship developed. Nothing in this case presents any substantive issues warranting review by this Court, as the issues identified are commonplace.

V. CONCLUSION

Respondent respectfully requests that Petitioner's Petition for Review be denied.

DATED this 10 day of March, 2017.

DUNN & BLACK, P.S.

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Attorneys for Respondent

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 10th day of March, 2017, I caused to be served a true and correct copy of the foregoing document to the following:

☐ HAND DELIVERY ☒ U.S. MAIL ☐ OVERNIGHT MAIL ☐ FAX TRANSMISSION ☒ EMAIL	Timothy G. Klashke Kuffel, Hultgrenn, Klashke, Shea & Ellerd, LLP 1915 Sun Willows Blvd., Suite A P.O. Box 2368 Pasco, WA 99302

Shellie Garrett

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