No. 31687-4-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.

BRIEF OF APPELLANT HSC REAL ESTATE, INC.

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

WASHINGTON STATE CASES

WASHINGTON CONSTITUTION

FEDERAL CONSTITUTION

WASHINGTON STATE RULES

I. INTRODUCTION

This case involves a fairly straightforward interpretation and construction of a written agreement between appellant HSC Real Estate, Inc. ("HSC"), as Agent, and VMSI, LLC ("VMSI"), as Owner, concerning management of an apartment complex in Richland, Washington. The agreement requires VMSI to defend and indemnify HSC against third party claims brought against HSC except in cases of negligence. But regardless of whether HSC is negligent, HSC "shall be indemnified to the extent of available insurance coverage." It also contains a separate insurance provision.

After a former resident filed suit against both HSC and VMSI over a sexual assault at the complex, HSC tendered the claims to VMSI under the contract. Receiving no response, HSC asserted cross-claims against VMSI under CR 13 for breach of both the contractual insurance and indemnity provisions of the management agreement. There were a number of summary judgment motions brought during the case by all parties, most of which are not pertinent to the present appeal.

After the assault victim's claims were settled, HSC renewed a previous motion for summary judgment on the indemnity provision, and

VMSI cross-moved for dismissal of HSC's cross-claims. The superior court denied HSC's motion and granted VMSI's cross-motion. In dismissing HSC's claims, the trial court interpreted the indemnity language quoted above to limit HSC's remedy to an action against VMSI's insurer(s).

The primary issue on appeal, then, is the proper interpretation and construction of the indemnity provision in the management agreement, which the superior court erroneously construed to preclude HSC's contractual cross-claims against VMSI.

II. ASSIGNMENT OF ERROR

The superior court erred in dismissing HSC's cross-claim against VMSI for contractual indemnity as a matter of law.

III. ISSUES PERTAINING TO ASSIGNMENT OF ERROR

1. Did the indemnity provision of the parties' management agreement limit HSC's claims so as to require VMSI to indemnify HSC against plaintiff's claims ***only*** to the extent of VMSI's available insurance coverage?

2. Did the superior court's interpretation of the parties' contract improperly effect an election of HSC's remedies to a stranger to the contract?

3. Did the superior court err to the extent it concluded that HSC had no damages?

IV. STATEMENT OF THE CASE

A. The Underlying Widrig Claims.

This case arises from a home invasion and sexual assault on Ms. Dana Widrig, a resident of The Villas at Meadow Springs ("The Villas") apartment complex in Richland, Washington, in the early morning hours of December 5, 2010. After initially positively identifying another suspect, Ms. Widrig eventually switched her positive identification to a maintenance technician at The Villas employed by HSC. Although he steadfastly maintained his innocence, the technician, Cody Kloepper, was tried and convicted of the crime. His case is currently on appeal to this Court, under Case No. 302946.

Once the criminal matter concluded, Ms. Widrig filed civil suit against numerous defendants. CP 1; CP 5. Eventually it was determined that none of the defendants except HSC and VMSI were proper defendants and Ms. Widrig voluntarily dismissed the others. *See, e.g.*, CP 38-40.

Both VMSI and HSC appeared and answered plaintiff's complaint and amended complaint, asserting cross-claims against each other. VMSI pleaded a "contingent" claim for equitable indemnity against HSC, while

HSC asserted mandatory cross-claims against VMSI predicated on a written contract. *See* CP 31; CP 12-15.

Ms. Widrig's claims were ultimately resolved by settlement in February 2013. CP 38-40. This left only the cross-claims in the case. CP 40.

B. The Claims at Issue Arise From a Written Management Contract Between HSC and VMSI.

The contractual claims at issue are based upon a written agreement between HSC Real Estate, Inc., as "Agent" and VMSI, LLC, as "Owner" dated October 25, 2004, for the management of The Villas as Meadow Springs ("The Villas") apartments in Richland, Washington. CP 59-64.

At the time of contracting the parties agreed on two risk allocation provisions: an insurance provision in Section 10 and an indemnification provision in Section 11.

Section 10 provides that VMSI, as the owner, shall obtain liability insurance naming HSC, as agent, as an additional insured:

> Owner ***shall obtain and keep in force*** adequate insurance . . . against liability . . . for loss, damage or injury to property or persons which might ***arise out of the occupancy, management, operation or maintenance*** of the Project. . . . Agent shall be covered as an additional insured on all liability insurance maintained with respect to

> the Project. Liability insurance shall be adequate to protect the interests of both Owner and Agent and in form, substance and amounts reasonably satisfactory to Agent.

CP 62 at §10.i. (Emphasis added). It is not disputed that the allegations of Ms. Widrig's complaint and her claims arise out of "the occupancy, management, [and/or] operation" of The Villas. It is also undisputed that VMSI had both primary (Fireman's Fund) and excess (Chub) liability insurance. *See* CP 277.

In addition, Section 11 of the management agreement between VMSI and HSC provides:

> INDEMNIFICATION OF AGENT; Except in cases of negligence or Agent's intentional misconduct, Owner shall release, indemnify, defend and save Agent harmless from all suits, claims, assessments and charges which pertain to the management and operation of the Project. The Project's duty to indemnify shall include all litigation expenses including reasonable attorney's fees. ***Regardless of Agent's conduct, Agent shall be indemnified to the extent of available insurance coverage.***

CP 62 at § 11 (emphasis added). Here, plaintiff's complaint and amended complaint allege negligence by both VMSI and HSC, but the case was dismissed without a finding of negligence against either defendant. *See*

CP 38-40.

Upon receipt of the summons and complaint, HSC tendered defense and indemnity to VMSI under the terms of the agreement. *See* CP 299. When the tender was not accepted by VMSI or its insurers, HSC filed a cross-claim asserting breach of both the insurance provision of Section 10 and the defense and indemnity provision of Section 11. CP 12-15.

C. HSC's and VMSI's Cross-Motions for Summary Judgment.

There were several motions for summary judgment filed on the cross-claims in this case. The first motion was filed by VMSI on July 5, 2012, as part of VMSI's larger motion seeking a summary judgment dismissal of plaintiffs' claims. *See* CP 351-54. HSC opposed that motion and filed its own cross-motion for summary judgment of liability on its cross-claims. *See* CP 326; CP 50-51. The Honorable Robert Swisher, granted the cross-motion in part and denied it in part – ruling for HSC that the management agreement, including Sections 10 and 11, was valid and enforceable, and ruling for VMSI that HSC was estopped from asserting that the face amount of VMSI's insurance policies was inadequate. CP 50-53. All other relief was denied. *See id.*

Because the issue of insurance was intrinsic to the cross-claims, Judge Swisher also bifurcated the cross-claims for resolution after resolution of Ms. Widrig's claims. *See id.* Ms. Widrig's claims were resolved and dismissed by stipulation on February 6, 2013. *See* CP 38-40.

Once Ms. Widrig's claims were dismissed, HSC filed a renewed motion for summary judgment of liability against VMSI on the cross-claims. CP 41-54. This was based on the fact that, although Ms. Widrig's claims were resolved without any contribution from HSC or its insurers, the duty to indemnify under the contract's language "shall include all litigation expenses including reasonable attorney's fees." CP 62. It was and remains undisputed that neither VMSI nor its insurers have paid any of HSC's fees or costs incurred in the litigation. CP 93-94. Therefore, HSC still had indemnity damages under the contract regardless of the settlement of Ms. Widrig's claims.

VMSI responded seeking dismissal of the claims on much the same basis as on its original motion for summary judgment. CP 276-87. Because Judge Swisher, who ruled on the earlier motions, was unavailable, the renewed motions were heard by Judge Cameron Mitchell on March 8, 2013. *See* CP 395. At the hearing, Judge Mitchell orally granted VMSI's cross-motion for dismissal of HSC's cross-claims, but he

took under advisement VMSI's request for prevailing party attorney's fees and costs. *See id.* On March 19, Judge Mitchell issued a letter ruling on VMSI's entitlement to a judgment for fees and costs and enclosed a copy of the order on summary judgment. *See* CP 395-98.

HSC timely filed a motion for reconsideration of the order on summary judgment. *See* CP 399-411. That motion was denied by order dated April 23, 2013. CP 415-19. This appeal followed.

V. SUMMARY OF ARGUMENT

Fundamentally, the superior court erred in interpreting and construing the indemnity provision of the management agreement to preclude HSC's claim for indemnity against VMSI. In doing so, the superior court melded the two separate indemnity provisions of Section 11 together when the scope of each was different. The first provided broad defense and indemnity if HSC was not negligent, but the second provided no defense and limited indemnification for more culpable conduct. Instead of interpreting and construing these provisions so that each were given effect, Judge Mitchell agreed with VMSI's arguments the negation of the duty under the first part of Section 11 in cases of negligence meant that HSC was precluded from asserting an indemnity claim directly against VMSI under the second part, rather than against VMSI's insurer(s).

This was error because the contract is between only HSC and VMSI, and the provision at issue concerns only contractual indemnity owed by VMSI to HSC. The insurance carriers are not contracting parties. In effect, the superior court re-wrote the contract to provide that HSC "shall be indemnified [only by VMSI's insurer(s)] to the extent of available insurance coverage." Since no insurer is a party to the contract, the superior court's rewriting of the agreement renders the entire provision ineffective – contrary to Washington's well-settled rules of contract interpretation and construction.

Under the correct interpretation and construction of Section 11 of the management agreement, VMSI is required to indemnify HSC, regardless of HSC's conduct, to the extent of VMSI's available insurance coverage. This necessarily allows HSC to assert direct claims against VMSI for indemnity, but to enforce any judgment only to the extent of the available coverage. The result – as intended by the parties – is that VMSI's individual assets and bank accounts are not in play.

Moreover, it was error to force an election of remedies on HSC to pursue claims only against VMSI's insurer(s), rather than pursue a direct breach of contract claim against the counter-party VMSI, for which the enforcement of any judgment – much as in the bankruptcy context – would

be limited to the insurance coverage available to VMSI. There were two separate contractual means of allocating future risk: (1) indemnity, and (2) insurance protection. The trial court's interpretation impermissibly blended the two together.

Because neither VMSI nor its insurers ever paid HSC's attorney's fees and costs in the litigation – which under Section 11 are subject to the indemnity obligation – those are contractual indemnity damages presently due and owing to HSC. To the extent the superior court concluded that HSC had no damages on its cross-claims, this too was error.

Since the interpretation and construction of the contract at issue is a matter of law, this Court should reverse the superior court's order on summary judgment and remand with direction to enter judgment of liability in favor of HSC on its cross-claims.

VI. ARGUMENT

Although th superior court offered some after the fact analysis in its denial of HSC's motion for reconsideration (CP 417), the exact basis for the superior court's decision to deny HSC's motion for summary judgment and grant VMSI's cross-motion to dismiss HSC's cross-claims remains unclear from the present record. Based on VMSI's arguments to the court, it appears that the dismissal was granted because the superior

court (1) concluded that the language in Section 11 stating, "Regardless of Agent's conduct, Agent shall be indemnified to the extent of available insurance coverage" meant that HSC can only seek indemnification directly from VMSI's insurers and/or (2) HSC has no damages due to any breach by VMSI of its duty to indemnify HSC. *See* CP 276-87. Regardless of whether the ruling was based on either one or both of these bases, the superior court committed reversible error and should be reversed.

A. The trial court erred in its interpretation of the last sentence of Section 11, stating: "Regardless of Agent's conduct, Agent shall be indemnified to the extent of available insurance coverage."

The issues on appeal all depend on the proper interpretation and construction of the management contract between HSC and VMSI and, in particular, the indemnity provision of Section 11 of the agreement. VMSI argued, and the superior court apparently agreed, that the phrase, "to the extent of available insurance coverage," means that HSC's remedies for VMSI's admitted failure to indemnify HSC are limited to pursuing VMSI's insurer(s). *See* CP 283-85. The superior court is in error for at least two separate reasons. First, contrary to Washington law, it effectively reads VMSI's indemnity obligation in Section 11 out of the

contract rendering it essentially meaningless. Second, the court's ruling purports to limit HSC's remedies for breach to a direct action against VMSI's insurer(s), rather than VMSI.

1. The standard of review is de novo.

In this case, review of the superior court's interpretation and construction of the parties' management agreement is de novo.

Interpretation and construction are distinguishable in that "interpretation" involves a determination of the meaning of the words and phrases written in the contract to ascertain the "intent" of the parties, while "construction" involves a determination of their legal effect. *See, e.g., Berg v. Hudesman*, 115 Wn.2d 657, 663, 801 P.2d 222 (1990).

Interpretation of a contract is generally an issue of fact, and "is a question of law only when (1) the interpretation does not depend on the use of extrinsic evidence, or (2) only one reasonable inference can be drawn from the extrinsic evidence." *Tanner Elec. Co-op. v. Puget Sound Power & Light Co.*, 128 Wn.2d 656, 674, 911 P.2d 1301 (1996). In this case, because there is no extrinsic evidence in the record concerning the parties' intent, the interpretation cannot depend upon the use of extrinsic evidence. So interpretation of the contract is an issue of law reviewed de novo. *See id.* Similarly, "the construction or legal effect of a contract is

determined by the court as a matter of law." *Yeats v. Estate of Yeats*, 90 Wn.2d 201, 204, 580 P.2d 617 (1978). Thus, for both the interpretation and construction of the management agreement, this Court's review is de novo.

2. The superior court failed to apply general rules of contract interpretation and construction requiring that all provisions be given effect.

a. *Indemnity agreements are interpreted and construed the same as other contracts.*

As the Washington Supreme Court recently reaffirmed, "indemnification agreements are to be interpreted in the same way as other contracts." *Snohomish County Publ. Transp. Benefit Area Corp. v. FirstGroup America, Inc.*, 173 Wn.2d 829, 835, 271 P.3d 850 (2012), *citing Jones v. Strom Constr. Co.*, 84 Wn.2d 518, 520, 527 P.2d 1115 (1974). In doing so, Washington courts apply the "context rule," which allows admission of the surrounding circumstances and other extrinsic evidence "to determine the meaning of *specific words and terms used*" and not to "show an intention independent of the instrument" or to "vary, contradict, or modify the written word." *Hearst Comm., Inc. v. Seattle Times Co.*, 154 Wn.2d 493, 503, 115 P.3d 262 (2005) (emphasis original), *quoting Hollis v. Garwall, Inc.*, 137 Wn.2d 683, 695-96, 974 P.2d 836

(1999). Thus, the context rule cannot be used to establish an intention by the parties independent of the contract. *See In re Marriage of Schweitzer*, 132 Wn.2d 318, 327, 937 P.2d 1062 (1997). Rather, the court imputes "an intention corresponding to the reasonable meaning of the words used." *Hearst*, 154 Wn.2d at 503, *citing Lynott v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 123 Wn.2d 678, 684, 871 P.2d 146 (1994). Conversely, "an interpretation of a contract that gives effect to all provisions is favored over an interpretation that renders a provision ineffective, and a court should not disregard language that the parties have used." *Snohomish County*, 173 Wn.2d at 856, *citing Wagner v. Wagner*, 95 Wn.2d 94, 101, 621 P.2d 1279 (1980). Consistent with this, "the subjective intent of the parties is generally irrelevant if the reasonable intent can be determined from the words used." *Id.* at 504, *citing City of Everett v. Estate of Sumstad*, 95 Wn.2d 853, 855, 631 P.2d 366 (1981).

The court should give the words used "their ordinary, usual, and popular meaning unless the entirety of the agreement clearly demonstrates a contrary intent." *Id., citing Universal/Land Constr. Co. v. City of Spokane*, 49 Wn. App. 634, 637, 745 P.2d 53 (1987). Finally, the court is "not to interpret what was intended to be written but what was written." *Id., citing J.W. Seavey Hop Corp. of Portland v. Pollock*, 20 Wn.2d 337,

348-49, 147 P.2d 310 (1944). A "contract will be given a practical and reasonable interpretation that fulfills the object and purpose of the contract rather than a strained or forced construction that leads to an absurd conclusion, or that renders the contract nonsensical or ineffective." *Wash. Publ. Util. Districts' Util. Sys. v. Publ. Util. Dist. No. 1 of Clallam Co.*, 112 Wn.2d 1, 11, 771 P.2d 701 (1989).

"[A]n indemnity agreement is often one tool among many employed to allocate risks between parties." *Snohomish County*, 173 Wn.2d at 836, *citing McDowell v. Austin Co.*, 105 Wn.2d 48, 54, 710 P.2d 192 (1985). Indeed, both the United States and Washington have Constitutional provisions recognizing freedom of contract and prohibiting impairment of contractual obligations. *See Mears v. Scharbach,* 103 Wn. App. 498, 12 P.3d 1048 (2000), *citing* U.S. CONST. art. 1, §10, cl.1 and WASH. CONST. art. 1, §23.

b. ***The superior court effectively negated VMSI's contractual promise to indemnify HSC to the extent of VMSI's available insurance coverage.***

Here, the superior court effectively deleted VMSI's obligation to indemnify HSC "to the extent of available insurance coverage" right out of the contract. Since the provision is not enforceable against anyone other than VMSI, the superior court's ruling renders it entirely ineffective in

violation of Washington rules of contract interpretation. *See Snohomish County*, 173 Wn.2d at 856, *citing Wagner v. Wagner*, 95 Wn.2d 94, 101, 621 P.2d 1279 (1980); *Wash. Publ. Util. Districts' Util. Sys. v. Publ. Util. Dist. No. 1 of Clallam Co.*, 112 Wn.2d 1, 11, 771 P.2d 701 (1989).

While the superior court reasoned (in its denial of HSC's motion for reconsideration) that HSC's argument actually required the court to ignore the first sentence of the indemnity provision excusing VMSI's duty to defend, indemnity, and hold harmless in cases of negligence, respectfully, the superior court was mistaken. The way Section 11 works when read as a whole is that, except in cases of negligence or [HSC's] intentional misconduct, [VMSI] shall release, indemnify, defend, indemnify and save [HSC] harmless . . ." CP 62. That obligation applies regardless of whether VMSI has any insurance coverage for the obligation. *See id.* So VMSI is assuming a far greater risk to its own assets "except in cases of negligence." *Id.*

The promise of the last sentence of Section 11 is different in that, in cases of negligence, i.e., "regardless of Agent's conduct," VMSI is assuming no present duty to defend, only a future duty to indemnify "to the extent of available insurance coverage." *Id.* In the later promise VMSI is placing none of its own assets at risk, i.e., it is assuming a

broader duty of indemnification, but further limiting the risk to its own assets by circumscribing HSC's ability to recover only to "the extent of available insurance coverage." *Id.* Thus, contrary to the superior court's conclusion on reconsideration, there is nothing about HSC's interpretation and construction of the last sentence of Section 11 that requires a court to "ignore" or "give no meaning" to the language in the first sentence. They are simply different in their scope, focus, and relative apportionment of risk.

As a matter of law, the superior court's reasoning, albeit after the fact, concerning the interpretation and construction of the indemnity obligations under Section 11 of the management agreement was in error, and should be reversed.

B. The Superior Court Erred in Ruling that HSC's Sole Remedy Under the Indemnity Provision of the Management Agreement is Against VMSI's Insurers.

Directly related to the superior court's error in interpreting the meaning of Section 11 of the contract, VMSI argued, and the superior court apparently agreed, that the phrase, "to the extent of available insurance coverage," means that HSC's remedies for VMSI's admitted failure to indemnify HSC are limited to pursuing VMSI's insurer(s). *See* CP 283-85. To the extent the superior court granted summary judgment to

VMSI on this basis, it erred because it purports to limit HSC's remedies for breach of contract to a direct action against VMSI's insurer(s), rather than the contracting party, VMSI.

As the Washington Supreme Court recently reaffirmed in *Condon v. Condon*, 177 Wn.2d 150, 298 P.3d 86 (March 21, 2013), a court cannot limit a party's remedies beyond the limitations expressed in the contract.

In *Condon*, the issue was a settlement agreement the parties negotiated and agreed to pursuant to CR 2A. The defendant later sought to require the plaintiff to also execute a broad release that was neither negotiated nor mentioned in the CR 2A agreement, arguing such a release was "common practice." *Condon*, 177 Wn.2d at 155. The trial court found the release implied in the settlement and ordered the plaintiff to execute it. The Washington Supreme Court reversed, holding that the defendant could not limit the plaintiff's remedies by requiring a release that was not expressly stated in the settlement. *Id.* at 163.

As the recent holding in *Condon* makes clear, the superior court erred because the sentence at issue in the indemnity provision does not expressly limit HSC's remedies to a stranger to the contract, i.e., a separate cause of action against the insurer issuing the insurance policy obtained by VMSI, rather than directly against VMSI. Whether such a cause of action

against the insurer even exists cannot be determined from the management agreement, but only from the terms of the applicable insurance policy – and the party to that contract, Fireman's Fund, was not a party to the case. Accordingly, the trial court erred in concluding that HSC's remedies under the management agreement's indemnity provision were limited to action against VMSI's insurer(s), rather than VMSI under the language stating, "[r]egardless of Agent's conduct, Agent shall be indemnified to the extent of available insurance coverage." CP 62.

The logical deduction is as follows: First, the indemnity provision of the contract is interpreted like any other contract language according to what was written, not necessarily what VMSI wishes was written. *See J.W. Seavey Hop Corp.*, 20 Wn.2d at 349. By the terms of Section 11 as a whole, the indemnification provision is a contractual obligation of VMSI, the owner, not its insurance company. As the earlier provision provides: "Owner shall release, indemnify, defend and save Agent harmless ..." CP 62. The only parties to the contract are HSC, as Agent, and VMSI, as Owner. *See id.* So the only reasonable interpretation of the last sentence of the indemnity provision is that, "regardless of [HSC's] conduct, [HSC] shall be indemnified [by Owner] to the extent of available insurance coverage." *Id.* at §11. There is simply no other party to the contract with

an indemnity obligation under the contract to the Agent, HSC.

Second, HSC's position on summary judgment that the phrase "to the extent of available insurance coverage" means that HSC can, similarly to the bankruptcy context, pursue its cause of action directly against VMSI to judgment, with only its ability to collect on that judgment limited to the insurance coverage available to VMSI is the law in Washington. *See Arreygue v. Lutz*, 116 Wn. App. 938, 69 P.3d 881 (2003); *see also, Werlinger v. Warner*, 126 Wn. App. 342, 109 P.3d 22 (2005); *Cambridge Townhomes, LLC v. Pac. Star Roofing, Inc.*, 166 Wn.2d 475, 209 P.3d 863 (2009).

In *Arreygue*, the trial court dismissed plaintiff's claims because the defendant had received a discharge in bankruptcy. Division III of the Court of Appeals reversed, holding that plaintiffs could maintain the case against the defendant for the "purpose of establishing her liability in order to recover from her insurance company." 116 Wn. App. at 939. Similarly, in *Cambridge Townhomes*, the Washington Supreme Court ruled in a case of successor liability in which a plaintiff, Polygon Homes, had earlier obtained relief from a bankruptcy stay "for the purpose of pursuing any insurance proceeds that are the result of any insurance coverage the Debtor [defendant Utley] may possess." 166 Wn.2d at 480. That is exactly what

HSC seeks to do in this case under the indemnity provision because VMSI's insurance company's indemnity obligation under the policy, like every insurance policy, is not triggered until there is a judgment of liability against VMSI. Thus, HSC cannot proceed against the insurer(s) until it has a judgement of liability against VMSI.

Washington is not unusual in this respect. Our law is consistent with the law in other jurisdictions. *See Arnold v. Krause, Inc.*, 232 F.R.D. 58 (W.D.N.Y. 2004) (noting prior procedural history granting relief from bankruptcy stay to allow plaintiff to proceed against defendant "to the extent of available insurance coverage for [defendant]."); *Herzfeld v. Herzfeld*, 781 So.2d 1070, 1080 (Fla. 2001) (Noting Florida's waiver of sovereign immunity from suit "to the extent of available insurance coverage."); *Owens v. City of Greenville*, 722 S.E.2d 755, 758-59 (Ga. 2012) (Discussing Georgia statute waiving sovereign immunity "by the purchase of liability insurance . . . and then only to the extent of the limits of such insurance policy."); *Withers v. U. of Kentucky*, 939 S.W.2d 340, 344-45 (Ky. 1997) (Discussing and abrogating line of cases holding partial waiver of sovereign immunity "to the extent of available insurance coverage.").

In the *Arnold* case, the plaintiff was allowed to proceed with a

lawsuit against the bankrupt defendant to judgment, which would then only be paid to the extent of the defendant's available insurance coverage. In the other cases, *Herzfeld*, *Owens*, and *Withers*, the issue was the waiver of sovereign immunity when the otherwise immune party had insurance so that the plaintiff could proceed to judgment against the otherwise immune defendant to obtain the benefits of the defendants' insurance policies.

Third, and intertwined with the first two, the trial court's decision implies that the contract intends an election of HSC's remedies for VMSI's contractual breach against VMSI's insurer, rather than directly against VMSI. But it is long-settled law that, "the doctrine of election of remedies cannot be applied between one of the parties to a contract and a third person, a stranger thereto, since it is applicable only to the parties to the contract." *Wolarich v. Van Kirk*, 36 Wn.2d 212, 216, 217 P.2d 319 (1950), *quoting Godefroy v. Reilly*, 146 Wash. 257, 264, 262 P. 639, 642 (1928). As the court in *Godefroy* stated, "[t]he principles governing election of remedies are necessarily based upon the supposition that two or more remedies exist." 146 Wash. at 265.

Here, the trial court's ruling that HSC's sole remedy was against VMSI's insurers actually likely precludes a recovery of the insurance proceeds by HSC because one cannot garnish an insurance policy simply

by asserting a third party claim against it. *See, e.g., Postlewait Constr. Inc. v. Great American Ins. Cos.*, 106 Wn.2d 96, 101, 720 P.2d 805 (1986) ("the lessor can sue the lessee, then if judgment is obtained against the lessee, the lessee's insurer can, if necessary, be garnished."); s*ee Philadelphia Fire & Marine Ins. Co. v. City of Grandview*, 42 Wn.2d 357, 361, 255 P.2d 540 (1953) (holding garnisher on insurance policy must establish liability of insured, coverage under the policy, and amount of judgment); *Berschauer Philips Constr. Co. v. Mut. of Enumclaw Inc. Co.*, 175 Wn. App. 222, – P.3d – , (2013), fn 14. Rather, one needs a judgment before one can garnish the insurance policy of the wrongdoer. *See ids.* In short, the trial court ordered a non-existent remedy as HSC's sole remedy for VMSI's breach.

Fireman's Fund is not a party to the management agreement and cannot be sued on its breach. So HSC literally has no election to proceed against Fireman's Fund on VMSI's breach of the contractual indemnity provision, the superior court's apparent conclusion to the contrary notwithstanding. Accordingly, to the extent the superior court concluded that HSC's remedy, if any, is against VMSI's insurer, rather than VMSI, is error and should be reversed.

C. The Superior Court Erred in Concluding that HSC Has

No Damages Because Its Own Insurer Defended It Against Plaintiff's Claims.

VMSI argued that because "HSC has not been required to pay any claim in the underlying action [by Ms. Widrig], so there is no right of indemnity." CP 280. The superior court's apparent acceptance of VMSI's "no damages" argument because VMSI's insurer settled plaintiff's claim and HSC's insurer paid for its defense is erroneous as such an argument is without merit under settled Washington law. *See McRory v. Northern Ins. Co. of N.Y.*, 138 Wn.2d 550, 558-59, 980 P.2d 736 (1999) (Rejecting defendant's "no damages" argument that plaintiff was fully defended and indemnified by his excess carrier). As Section 11 of the management agreement expressly provides, the duty to indemnify "shall include all litigation expenses, including reasonable attorney's fees." CP 62. And it is undisputed that neither VMSI nor its insurers paid HSC's litigation expenses, including attorney's fees. Accordingly, to the extent the superior court accepted VMSI's "no damages" argument in dismissing HSC's cross-claims, it was reversible error.

HSC recognizes that it did not pay to settle plaintiff's claims, but that does not absolve VMSI of its contractual obligation under Section 11 of the written management agreement to indemnify HSC against the

expenses of the litigation, including attorney's fees. *See id.*; *See also McRory,* 138 Wn.2d at 558-59. This is not a principle of recent vintage. Rather, it is dictated by Washington's collateral source rule.

The collateral source rule in Washington provides:

> [b]enefits received by a plaintiff from a source collateral to the tortfeasor or contract breacher may not be used to reduce a defendant's liability for damages. This collateral source rule holds true even if the benefits are payable to the plaintiff because of the defendant's actionable conduct.

Goodman v. The Boeing Co., 75 Wn. App. 60, 86-87, 877 P.2d 703 (1994), *quoting Hayes v. Trulock*, 51 Wn. App. 795, 803, 755 P.2d 830 (1988). It applies "when the payment comes from a source independent of" the defendant. *Matsyuk v. State Farm Fire & Cas. Co.*, 173 Wn.2d 643, 657, 272 P.3d 802 (2012); *Ciminski v. SCI Corp.*, 90 Wn.2d 801, 804, 505 P.2d 1182 (1978) ("Under the collateral source rule, payments, the origin of which is independent of the tort-feasor, received by a plaintiff because of injuries will not be considered to reduce the damages otherwise recoverable."). Thus, under this authority, any settlement paid to plaintiff by Fireman's Fund, VMSI's insurer, is not a collateral source of funding to HSC independent of VMSI. So HSC is not able to assert the settlement amount as part of its indemnity damages. However, HSC's claims for its

fees, costs, and expenses incurred in defense of plaintiff's claims and attempted mitigation are another matter.

The insurance HSC purchased from National Union Fire Insurance Company of Pittsburgh, PA, which paid the fees, costs, and expenses of defending plaintiff's claims, is a collateral source independent of VMSI and therefore those fees, costs, and expenses remain damages of HSC. *See McRory v. Northern Ins. Co. of N.Y.*, 138 Wn.2d 550, 558, 980 P.2d 736 (1999). VMSI's insurer did not pay any of the fees, costs, and expenses incurred by HSC, but provided only a vague assurance that it will reimburse some portion of the fees and costs without indicating how much. *See* CP 390; CP 93-94 ¶ 9. In short, Fireman's Fund did not agree to hold HSC harmless from all fees, costs, and expenses of the litigation, which is the scope of VMSI's contractual indemnity duty to HSC. *See* CP 62 at § 11.

In *McRory*, the insured was defended by his excess insurance carrier, Wausau, which settled the underlying matter after incurring "significant defense fees and costs." *McRory*, 138 Wn.2d at 553. He then sued his primary carrier, Northern, for failing to defend and indemnify him under its insurance contract and seeking the fees and costs incurred by Wausau in defense of the underlying suit. *Id.* at 553-54. As the

Washington Supreme Court reasoned and held in *McRory*:

> Moreover, the fact that an insurer pays an insured or an insured agrees to reimburse its insurer for payments made by the insurer in the event the insured successfully sues a liable third party, does not affect the insured's status as the real party in interest in such suit ***nor the insured's ability to recover all damages and costs.***

Id. (Emphasis added). Thus, in *McRory*, the court rejected the primary insurer's "no damages" argument stating, "[i]ndeed, McRory received the benefit of its bargain with Wausau, but not from Northern. We rejected a similar 'no damages' argument in an analogous setting long ago." *Id.* at 559, *citing Alaska Pac. S.S. Co. v. Sperry Flour Co.*, 94 Wash. 227, 230, 162 P. 26 (1917) ("Nor does it seem that a wrongdoer should not respond for his wrongful acts in damages to the insured and thereby profit by reason of the sagacity of the insured in keeping his property protected by insurance."). In effect, the fees and costs paid by McRory's excess insurer on his behalf were a collateral source independent of his primary insurer.

The principle that attorney's fees incurred or paid by insurance, whether as prevailing party fees in the case or damages on the underlying claim, are a collateral source independent of the wrongdoer recoverable by plaintiffs is well recognized. *See Fust v. Francois*, 913 S.W.2d 38, 47

(Mo. Ct. App. 1995) (Holding plaintiffs' attorneys' fees in underlying case were damages regardless of payment of fees by their insurer; payment was a collateral source independent of defendant and whether plaintiffs "paid the law firm directly for the fees is irrelevant."), *cited in Space Labs Med. v. Farah*, 94 Wn. App. 1039 (Unpubl. 1999); *Bangert v. Beeler*, 470 So.2d 817 (Fla. Dist. Ct. App. 1985) (Reversing trial court's "no damages" ruling, and holding attorney fees incurred in defending underlying action and paid by plaintiff's title insurer were damages in third party action subject to collateral source rule); *Isaacs v. Jefferson Tenants Corp.*, 270 A.D.2d 95 (N.Y. App. Div. 2000) (Affirming award of prevailing defendant's attorney fees and costs paid by its insurer because "[p]laintiff may not benefit from the circumstance that the [defendant] had an insurance policy to cover its legal costs."); *Otis Elevator, Inc. v. Hardin Constr. Co. Grp., Inc.*, 450 S.E.2d 41, 45 (S.C. 1994) (Holding recovery of damages under contractual indemnity provision "will not be defeated by the fact the loss to be indemnified for was actually paid by an insurance company.") (citing numerous cases); *Graco, Inc. v. CRC, Inc., of Texas*, 47 S.W.3d 742 (Tex. App. 2001) (affirming trial court's award of prevailing party attorney fees paid by plaintiff's insurer as collateral source independent of defendant). These authorities are entirely consistent with

long-standing Washington law on both subrogation and the collateral source rule, both of which apply in this case. *See McRory v. Northern Ins. Co. of N.Y.*, 138 Wn.2d 550, 558, 980 P.2d 736 (1999); *Ciminski v. SCI Corp.*, 90 Wn.2d 801, 804, 505 P.2d 1182 (1978); *Consolidated Freightways, Inc. v. Moore*, 38 Wn.2d 427, 229 P.2d 882 (1951) ("Subrogation is an equitable principle and applies to contract rights as fully as it does to tort actions.").

So the fact that most collateral source cases arise in a tort setting is immaterial; the rule applies equally in a contract setting in Washington. *See Consolidated Freightways, Inc. v. Moore, supra,* and *Goodman v. Boeing, supra.* And that is precisely what is involved on HSC's cross-claims.

In sum, HSC's attorneys' fees, costs, and expenses incurred in this matter – other than those strictly on the cross-claims, which would be prevailing party fees – are, as a matter of law, damages to HSC properly asserted against VMSI on HSC's cross-claim for indemnity under Section 11 of the management agreement. Accordingly, to the extent the trial court concluded that HSC had no damages on its cross-claim, it erred and should be reversed.

D. <u>If the Superior Court Concluded that HSC Brought Its</u>

Cross-Claims for an Improper Purpose, It Erred.

To be clear, HSC does not believe that the superior court agreed with VMSI's argument that HSC asserted its cross-claims for "an improper purpose" or based its order of dismissal on that argument. *See* CP 285-87. It is only out of an abundance of caution that HSC mentions it at all. *See* CP 321-23. Rather, that portion of VMSI's summary judgment brief appears to be nothing more or less than an *ad hominem* screed against HSC's counsel, failing to request any particular relief for HSC's alleged "extortion." *See id.* In any event, aside from the fact the assertion is objectively baseless, whether HSC's claims were brought for an "improper purpose" is an inherently factual inquiry and, the asserted facts being disputed, was certainly not susceptible to resolution on summary judgment. Therefore, in the unlikely event that the superior court granted VMSI dismissal on this basis, it erred and should be reversed.

E. The Contract Entitles HSC to an Award of Attorney's Fees and Costs on Appeal.

Section 20 of the parties' management agreement provides that the prevailing party in any action to enforce or to interpret the terms and provisions of the agreement "shall be entitled to recover the reasonable costs and expenses of such litigation, including, but not limited to, the

reasonable fees and expenses of attorneys..." CP 64. Therefore, in accordance with RAP 18.1(b), HSC requests an award of its attorney's fees and costs incurred on the present appeal or a direction to the trial court to determine those fees and costs after remand in accordance with RAP 18.1(j).

VII. CONCLUSION

This Court should reverse the order on summary judgment and remand to the superior court with instructions to enter judgment of liability in favor of HSC against VMSI.

RESPECTFULLY SUBMITTED this 19th day of September, 2013.

Martens + Associates | P.S.

By_____
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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 19th day of September 2013 at Seattle, Washington.

Matthew Morgan
Paralegal for Martens + Associates | P.S.