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NO. 63667-7

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

RICHARD BANKSTON and SUSAN BANKSTON,
husband and wife and the marital community composed
thereof, d/b/a AAROHN CONSTRUCTION,

Appellants,

v.

DEVELOPERS SURETY AND INDEMNITY COMPANY,
a foreign corporation,

Respondent.

REPLY BRIEF OF APPELLANTS

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I. PRELIMINARY STATEMENT

In its response brief Respondent Developers Surety and Indemnity Company (“Developers”) continues to advocate a position that ignores the words it chose to use in its own Indemnity Agreement. Rather than focusing on its claimed right to indemnity against Richard and Susan Bankston (“Bankston”) Developers places great import on a subject that is undisputed – its own ability to pay the underlying claim. Developers’ right to pay Pierce County was never contested. The issue in this appeal is whether, after a voluntary and expedient payment to the obligor Pierce County, Developers can maintain an action against its principals Richard and Susan Bankston. In this instance, where there was no determination, or evidence of “liability” or “contingent liability” before Developers paid the underlying claim, the answer is “no.”

II. STATEMENT OF FACTS IN REPLY

A. Developers Did Not Conduct a Reasonable Investigation

Developers casts itself as having made an extensive investigation of every aspect of the dispute in order to arrive at a “studied and prudent decision” to pay Pierce County. *Brief of Respondent*, 8. The evidence at trial in no way supports this self-serving mischaracterization. The testimony from Developer’s claim attorney Lou White was that Developers never actively investigated Bankston’s side of the dispute

before making the expedient business decision to pay Pierce County. RP 567-68. The payment to Pierce County was based on Developers passive acceptance of Pierce County's version of events. Specifically, payment was made without regard to whether Aarhonn should have been given more time to finish the project under the contract with Pierce County pursuant to numerous change orders requesting additional time. RP 569. The payment was in no way based on a determination or ascertainment of "liability" or "contingent liability." It was based on the threats of Pierce County's attorney. RP 579. It was based on a failure to post collateral, even though no collateral was required under the Indemnity Agreement. RP 868. It was based on correspondence it requested, received and never reviewed. RP 567. Ultimately Developers concluded that Pierce County's demand was "as good a deal as we're going to get as a bonding company." RP 602. In.

Contrary to Developers conclusory assertions, the evidence at trial demonstrated that Aarhonn Construction responded to the Surety's request for information in writing. Trial Exhibit 37; Trial Exhibits 43; Trial Exhibit 45. John Bankston provided correspondence backing up the Aarhonn Construction position on the contract termination, reasonable cost of completion, and change order for additional time that were denied by Pierce County. RP 568, 1025-26; Trial Exhibit 37; Trial Exhibit 43;

Trial Exhibit 45. Even though Mr. White recognized that the primary issue regarding liability under the contract was additional; time, they made no decision regarding this issue. RP 583.

A detailed account of the alleged licensing irregularities perpetrated by project superintendent John Bankston dominates Developer's brief as it dominated their case at trial. There, as here, it is for no good purpose. Developers seeks indemnity against Richard and Susan Bankston, not Richard's father John Bankston. The judgment in this matter is against Richard and Susan Bankston, not John Bankston. CP 695-97. Richard contracted with Pierce County and Richard and his wife Susan signed the Indemnity Agreement. Trial Exhibit 2. John Bankston, who had extensive construction experience, acted as Richard Bankston's site superintendent and he had full authority to act on Richard's behalf. RP 798. Developer's suggestions to the contrary confuse the otherwise straightforward issues on appeal.

B. Developers' Indemnity Claim Never Arose

Developers contends that it need only pay a claim in order to have a right to seek indemnity. This assertion is consistent with its decision to ignore the contract itself as well as Bankston's numerous requests for additional time when it made its decision to pay. RP 567-68; 583. Amazingly, Developers blames Aarhonn for not providing enough

information when it admittedly was not reviewing the relevant materials that it already had been given, including the contract and the change orders. RP 567.

The sole issue on appeal is whether Developers has the right to seek indemnity for the amounts it paid under the terms of the Indemnification Agreement contained in the bond application where neither of the two events that triggered the right to indemnity against its principal occurred. Payment because of “expediency” is expressly contemplated under the terms of the agreement, but indemnity against the principal is authorized only where there is “liability” or “contingent liability.” Neither of these terms is defined. Lou White even concedes that the agreement is confusing. At one point Mr. White referred to the bond terms as “gobbelgook” and observed that “we don’t normally use English” when drafting these agreements. RP 464, 560.

By its own admission, payment was based on a business decision driven by expediency, not on a determination of “liability” or “contingent liability.” RP 564-565; 572; 579. Developers’ brief attempts to portray an orderly judicious process intended to determine “liability” or “contingent liability” where there was no evidence of such an effort presented at trial. RP 569, 583. Developers’ position at trial was that it could seek indemnity in almost any circumstance without regard to actual liability.

That Developers' decision to pay was a business decision is not more apparent anywhere than it is in its Settlement and Release with Pierce County. Trial Exhibit 20: Trial Exhibit 31. At Paragraph E of the Settlement and Release with Pierce County, Developers acknowledges that Aarohn continues to dispute liability to Pierce County and that "[Aarohn] believes it is entitled to additional compensation for work performed beyond the scope of the Contract" and that termination was "improper due to unforeseen site conditions." *Id.*, Pierce County agreed to pay the County the full amount of its demand in exchange for a release of its liability under the bond. *Id.*, at para. I. There was no recital or affirmation of liability or contingent liability, only an agreement to pay in exchange for a release. Pierce County did not assign any claim it may have had against Bankston.

Developers suggests reading the Indemnity Agreement without regard to how the words are to be read together and without giving meaning to each word. Developers' interpretation of the Agreement ignores the use of different words to mean different things. Here, the term "expediency" is used in the subjunctive with the terms "liability" and "contingent liability." The use of the different words in the different sections of the Indemnity Agreement clearly connotes that Developers has a right to pay in instances of "liability," "expediency or otherwise," but

has the right to seek indemnity only where there is “liability” or “contingent liability.” Accordingly, logic dictates that since different words are used to mean different things, the term “expediency” means something different than the terms “liability” and “contingent liability.” Such a reading is compelled by a basic rule of contract construction applicable to bonds and their indemnity agreements. Indemnity agreements in surety bonds should be construed as a whole, and if reasonably possible, in a way that effectuates all of its provisions. *Colo. Structures, Inc. v. Ins. Co. of the Wests*, 161 Wn. 2d 577, 588, 161 P.3d 1125 (2007).

The use of these different terms within the structure of the Indemnity Agreement makes it clear that the standard for when Developers can pay a claim is lower than the standard for when Developers is granted a right of indemnity against its principal. That the right to pay has a less stringent standard than the right to seek indemnity is a reasonable reading of the Indemnity Agreement that gives meaning to all of the words used.

The payment to Pierce County was based on “expediency” and without an ultimate decision as to liability. RP 555, 564. That the Surety’s affirmative right against its own principal for indemnity should be subject to a higher standard than the right to pay makes perfect sense.

In fact, common sense would suggest that Developers should have broader power to make a decision that affecting only its rights and liabilities. Where it is making a decision that creates a potential liability for others, in this case exposing its principal to a claim for indemnity, the standard is more exacting.

It remains undisputed that Developers was within its rights to pay Pierce County; however, since it paid based on expediency and not on a determination of liability or contingent liability, it does not have a right to seek indemnity against its principals Richard and Susan Bankston.

III. LEGAL ANALYSIS

A. DEVELOPERS HAS NO CLAIM FOR INDEMNITY

The Respondent advances the notion that since Indemnity Agreements are valid and enforceable, it must have a right to indemnity in this instance. Developers supports this fallacious statement with a misleading partial statement of the law: “[i]n absence of fraud or bad faith on the part of the surety, the indemnitor is held to the reimbursement terms of the express Indemnity Agreement.” Respondent’s Brief, p. 17, citing *Commercial Ins. Co. v. Pac. Peru Constr.*, 558 F.2d 948 (9th Cir. 1977). In reality, both the indemnitor and indemnitee are held to the terms of the Indemnity Agreement, including any terms defining or limiting the circumstances where the Surety has an actual right to indemnity. *Id.*

Moreover, that a payment was made in good faith is not a basis for the right to indemnity unless it is specifically identified as one in the indemnity agreement. See *U.S.F. & G v. Napier Electric*, 571 S.W.2d 644 (Ky. App. 1978).

Developers takes even greater liberties with the court's holding in *International Fidelity v. Spadafina*, 192 A.D.2d 637 (N.Y. App. 1993). Relying on *Spadafina*, Developers is so bold as to assert that it is "irrelevant" whether [the principal] was actually liable on the underlying debt[.]" This is a patently inaccurate statement of the case. *Spadafina* related to the enforcement of an indemnity agreement that expressly gave the surety the right to seek indemnity for all amounts it paid in "good faith." The term "good faith" was actually used in the indemnity agreement and it was therefore accepted as the applicable standard. The court was not setting out a general rule applicable to all indemnity agreements contained in bond applications. It was merely interpreting the contract before it according to its terms. That is precisely what Bankston is asking the court to do here with a vastly different indemnity agreement.

Although the court in *Commercial Insurance v. Pac. Peru*, *supra*, held that the surety was entitled to indemnity for amounts it paid to satisfy Peruvian judgments, the court recognized that the surety rights should be construed "strictly" and were 'not to be extended by implication or

inference beyond the bare scope of its terms.” *Id.* at 953. In this case, Developers reading of its own Indemnity Agreement intends to do just that – it extends the scope of its indemnity right beyond what is expressly called for in its own contract.

The Respondent’s analysis turns what should be a simple two step process under the Indemnity Agreement on its head. Rather than beginning with determining the existence and scope of the right to seek reimbursement under the Agreement, Developers I focuses on the language that gives it the “exclusive right” to decide whether to pay in any given instance. Developers ignores the clear distinction between the two concepts that its drafters expressed in its own Indemnity Agreement. The right to seek indemnity arises under paragraph 1 of the agreement, whereas the surety’s right to pay is contained at paragraph 2 of the Agreement: “[s]urety shall have the exclusive right to determine whether any claim or suit shall, on the basis of the liability, expediency, or otherwise, be denied, paid, compromised, defended or appealed . . . [.]” The surety is not similarly empowered to seek indemnity.

Reading the Indemnity Agreement as a whole, Developers’ ability to pay a claim contrasts sharply with the much narrower power to seek indemnity. Under the express terms of the Indemnity Agreement it drafted and imposed on Bankston, the right to seek indemnity is limited to those

instances where there is “liability” or “contingent liability.” Such a limitation is reasonable and consistent with the law governing the rights of a surety: “equity generally implies a right to indemnification in favor of a surety only when the surety pays off a debt for which his principal is liable.” *Commercial Insurance v. Pacific-Peru, supra*. Resort to implied indemnity principles is improper when an express indemnification contract exists and “is not to be extended beyond the bare scope of its terms.” *Id.* at 953.

Incredibly, the cases relied upon by Developers in its brief all have one key factual element in common. They all involve an indemnity agreement much broader than the one at issue here. The court in *Pacific-Peru* considered the surety’s right to seek payment of a foreign judgment where the principal agreed to indemnify for any loss “by reason . . . of having executed” the bond. *Id.* at 953.

The case cited by Developers most often in its brief involves an indemnity agreement that starkly demonstrates the shortcomings of its own. The court in *Spadafina* considered the right of a surety to seek reimbursement from its principal under a bond indemnity agreement providing that the surety could:

Charge [Spadafina] for any and all disbursements made by it in good faith in and about matters herein contemplated by this Agreement under the belief that it is or was liable for

the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, **whether or not such liability necessity or expediency existed** . . . [.]

Id. at 639 (emphasis added). The inclusion of the language “whether or not such liability necessity or expediency existed” gave the surety the almost unconditional right to seek indemnity. It is this unconditional right that Developers claims in this case, without the benefit of the same broad and inclusive unequivocal language.

Similarly, the court in *General Accident v. Merritt-Meridian Construction Corp.*, 975 F.Supp. 511 (1997), considered a bonding company’s right to seek indemnity under an agreement wherein

the Surety shall be entitled to charge for any and all disbursements made **by it in good faith** in and about the matters herein contemplated by this Agreement under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed; . . .

Id. at 514 (emphasis added). There, as here, the court affirmed that an indemnity agreement was enforceable **according to its terms**. *Id.* In *Merrit Meridian*, just as in *Spadafina*, however, the indemnity agreement provided that the Surety was expressly entitled to indemnity for those amounts it paid in good faith under the belief it was expedient, whether or not such liability, necessity or expediency existed. Neither case creates an exception for sureties that make payments in good faith – good faith

payment was an express basis for seeking indemnity under the indemnity agreements at issue.

The Indemnity Agreement in the Developers bond application (Trial Exhibit 2) bears no resemblance to those much broader agreements being construed and applied in the cases cited in the Brief of Respondent. It is apparent from its reliance on cases addressing much broader and more inclusive indemnity agreements, that Developers is not completely satisfied with its own. Developers is limited to the indemnity rights that are expressly granted in the Indemnity Agreement at issue.

Unlike the agreements discussed in the cases cited by Developers, there is no right to claim indemnity for payments that were based on "expediency." In this case, there was no evidence presented that DSI became liable or contingently liable to Pierce County. The evidence showed simply Pierce County made a claim and that Developers made the business decision to pay the claim. Developers' tepid review of the situation posed by Pierce County's claim resulted in nothing like a finding of liability or contingent liability. Moreover, as described fully above and in the initial brief, the evidence presented at trial showed that Developers did not bother to look at the contract documents or change order requests asking for additional time. Although it complains of not getting more requested information from Bankston, its claims attorney admitted that he

did not even bother looking at the documents that he did have before making the decision to pay. The Letter of Demand dated March 19, 2007 simply states that Developers has paid \$65,759.79, but is silent as to why, what the amount was paid for, or whether it was based on any determination of liability or contingent liability. Trial Exhibit 30. It goes on to misquote the requirements of the bond:

Enclosed is a copy of the Indemnity Agreement that you signed and in which you agreed to reimburse DSI for its loss and expense.

As explained in some detail already, the Indemnity Agreement provides for no such thing. The Indemnity Agreement was the only document attached. As further evidence of its bad faith toward Bankston it states that a failure to respond will result in “a negative statement . . . on your personal credit report.” *Id.*

By its own admission, Developers has paid for and is now seeking indemnity for items of alleged damages that bonds are statutorily proscribed from covering. RCW 19.72.107 provides:

- (2) A surety bond shall not be liable for damages based upon or arising out of any:
 - (a) Tortious injury, including death, to:
 - (i) Any person; or
 - (ii) Any real or personal property

Here, Developers clearly concedes that it made payment for property damage allegedly caused by Bankston's construction activities. At page 7 of its Brief, Developers claims to have made payment for "property damage caused by Aaron Construction." These items allegedly included a flood in the basement of the Annex, cut sprinkler pipes, and cut wiring. RP 536-39. In fact, Trial Exhibit 36 sets forth nearly \$70,000 of "property damage" items as part of the Serpanok repair contract. Trial Exhibit 36.

As these property damages were clearly not contemplated by Developers or Pierce County to be part of the contract for which the bond was issued, the claim for this damage is extra-contractual and would sound in tort. Accordingly, by its own admission, Developers made payment for items that were statutorily excluded from the coverage under the surety bond for which it clearly did not have liability or contingent liability.

Unfortunately, because of the failure of the trial court to dismiss its case after the end of its evidence, Developers was allowed to advance the fallacy that the right to pay is coextensive with the right to indemnity. It is not. The right to indemnity under certain specified conditions (i.e., a finding of "liability" or "contingent liability") is defined in the first paragraph of the Indemnity Agreement; the right to pay is delineated in the second. A correct reading of this Indemnity Agreement would result in a finding that in the absence of liability or contingent liability there was no

right to indemnity. Accordingly, it was error for the court to deny Bankston's motion to dismiss these claims after the close of Developers case.

B. THE TRIAL COURT ERRED WHEN IT FAILED TO DISMISS FOR LACK OF SUBJECT MATTER JURISDICTION

The dispute between Bankston and Developers is clearly derivitavie of any claim Pierce County may have brought under its contract for damage to the real property known as the Pierce County Annex. This included damages to the irrigation system, preexisting vegetation, and flooding damage in the basement of the building. These items were included in the Serpanok contract. Trial Exhibit 16.

Unlike "transitory" actions that may be brought in the county in which the defendant resides, actions for "any injuries to real property" must be brought in the county in which the subject of the action is situated. RCW 4.12.025. Here the contract between Pierce County and Bankston even had a venue provision requiring that all actions arising from the contract be brought in Pierce County. Exhibit 73, p. 5. The Bond itself references only the Pierce County Annex project. Unlike a statutory general contractor's bond, this bond was project specific. See RCW 18.27.

Under the circumstances, Developer's claim arising from injuries to Pierce County's real property, should clearly be brought in the county where the subject real property is located. *See Cugini v. Apex Mercury Mining Co.*, 24 Wn.2d 401, 406 (Wash. 1946). Accordingly, it was error for the trial court to deny Bankston's motion to dismiss on this basis.

C. DEVELOPERS WAS NOT ENTITLED TO PREJUDGMENT INTEREST

Developers claims that the payment to Pierce County was for a "contingent" liability. Moreover, Developers made significant payments for items for which it could not be liable State law. RCW 19.72.107. It cannot be disputed that the jury did exercised discretion as the amount of the jury award was approximately \$4,000 less than the \$64,259.79 paid by Developers to Pierce County. RP 695-75. Obviously, the Jury agreed that Developers was entitled to indemnity only to those amounts that, in its discretion, it should have paid. *See Prier v. Refrigeration Co.*, 74 Wn 2d 25, 32, 442 P.2d 621 (1968).

D. DEVELOPERS IS NOT ENTITLED TO ITS ATTORNEYS FEES ON APPEAL

After a motion was made to dismiss its attorneys' fees claim after the end of its case at trial, Developers agreed to a stipulated dismissal of those claims. Surprisingly, Developers now seeks them on appeal. The only legal source for these fees is the Indemnity Agreement at issue.

It is well settled that attorneys' fees recoverable pursuant to an indemnity agreement are an element of damages in the underlying case, not a cost of suit. *Jacob Meadow Owner's Association v. Plateau 44, LLC*, 139 Wn. App. 743, 163 P.3d 1153 (2007). Cost of suit is only recoverable where there is a clear attorneys' fee provision allowing for recovery of fees incurred pursuing a defaulting party under a contract. *Id.* at 762-63. In the instant case, there is absolutely no attorney fees provision other than that contained in the Indemnity Agreement itself. The recoverable attorneys' fees under the Indemnity Agreement are limited to those attorneys' fees incurred in connection with the underlying claim by Pierce County. These do not include fees incurred pursuing Richard and Susan Bankston in this lawsuit. *Id.* at 758.

Plaintiff Developers Surety has the burden of evidence as to the amount and reasonableness of these fees, and they are for the jury to determine in a case tried to the jury. *Jacob Meadow, supra*, 759-60. As an element of damages "the measure of the recovery of attorney's fees pursuant to the indemnification provision must be determined by the trier of fact." *Id.* at 760. "When trial is to a jury, therefore, the measure of such damages is a jury question." *Id.*

In the instant case, Plaintiff has presented absolutely no evidence of attorneys' fees incurred defending Pierce County's claims, or of any other

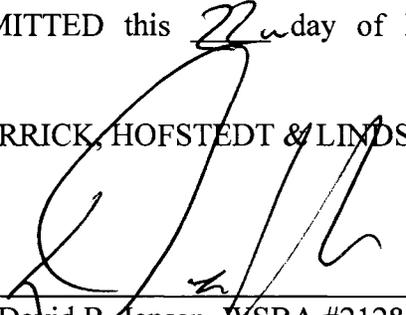
fees or costs incurred. When this was brought to the attention of counsel after the close of his client's case, Developers stipulated to a dismissal of its attorneys' fee claim. It should not now be allowed to seek its fees on appeal, and in any case, such a claim is not supported in the law. RAP 18.1.

IV. CONCLUSION

The trial court erred when it denied Bankston's motion to dismiss Developers claim for indemnity at the close of plaintiff's case. These claims should have been dismissed as a matter of law because there was no "liability" or "contingent liability" under the subject Indemnity Agreement, and because the trial court lacked jurisdiction. The trial court further erred when it granted Developers pre-judgment interest. This court should reverse the trial court and order Developers claims dismissed as a matter of law. Developers claim for attorneys' fees on appeal are without legal basis under RAP 18.1 and should also be dismissed.

RESPECTFULLY SUBMITTED this 22 day of February, 2010.

MERRICK, HOFSTEDT & LINDSEY, P.S.

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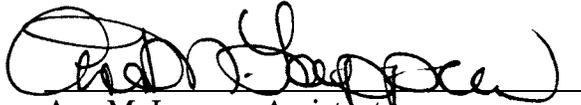
CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that a copy of **Reply Brief of Appellants**
was served February 22, 2010, on the following individuals:

Alexander A. Friedrich
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215 NE 40th Street, Suite C-3
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I declare under penalty of perjury under the laws of the State of
Washington that the foregoing is true and correct.

EXECUTED this 22nd day of February, 2010, at Seattle,
Washington.

A handwritten signature in black ink, appearing to read "Ann M. Lappan", written over a horizontal line.

Ann M. Lappan, Assistant to
David S. Jensen, WSBA #21284