

No. 44635-9-II

COURT OF APPEALS, DIVISION II,
OF THE STATE OF WASHINGTON

EAGLE SYSTEMS, INC., a Washington corporation;
GORDON TRUCKING, INC., a Washington corporation;
HANEY TRUCK LINE, INC., a Washington corporation;
JASPER TRUCKING, INC., a Washington corporation;
KNIGHT TRANSPORTATION, INC., an Arizona corporation;
PSFL LEASING, INC., a Washington corporation; and
SYSTEM-TWT TRANSPORTATION,
a Washington limited liability company,

Respondents/Cross-Appellants,

v.

STATE OF WASHINGTON EMPLOYMENT
SECURITY DEPARTMENT,

Appellant/Cross-Respondent.

REPLY BRIEF OF RESPONDENTS/CROSS-APPELLANTS

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A. INTRODUCTION

ESD dragged out the Carriers' administrative appeals for nearly three years and then tried to repudiate the very agreement that it proposed and that the Carriers accepted to resolve those appeals. The trial court ultimately enforced the parties' agreement. Despite having witnessed first-hand ESD's desperate attempt to conjure frivolous reasons to avoid settlement, the trial court declined to sanction ESD. ESD's attempt to avoid the parties' agreement was frivolous and contrived. It should have been sanctioned.

Nothing presented in ESD's response brief overcomes the basic legal proposition cited in the Carriers' brief on cross-review that the trial court abused its discretion by failing to sanction ESD for its bad faith conduct. This Court should reverse the trial court's decision declining to sanction ESD. The Court should also order ESD to pay the Carriers' fees on appeal because ESD's appeal is frivolous. RAP 18.7; RAP 18.9(a).

B. RESPONSE TO ESD'S FACTUAL STATEMENTS

ESD does not include a separate counterstatement of the facts in its response to the Carriers' cross-appeal and instead makes its factual assertions within its argument. A number of ESD's statements require clarification from the Carriers because they are untrue or misleading.

For example, ESD claims that it did not delay the administrative proceedings before Administrative Law Judge Todd Gay (“the ALJ”). ESD br. at 28. ESD misrepresents the basis for the delays the Carriers experienced, starting with its discussion of the Carriers’ federal lawsuit. *Id.* While ESD correctly notes that the district court dismissed that lawsuit, it neglects to mention that the court dismissed the lawsuit *without prejudice* on the basis of the Tax Injunction Act, 28 U.S.C. § 1321. More importantly, the Carriers’ federal lawsuit did not delay the administrative proceedings then-pending before the ALJ. The case was resolved on motions. The parties did not engage in any discovery and the suit was dismissed early in the proceeding on motion. The federal action was not an excuse for ESD’s foot-dragging in the administrative process.

ESD also engages in revisionist history on settlement. ESD br. at 29. For example, it inaccurately states that the parties *voluntarily* engaged in settlement negotiations. *Id.* On the contrary, the ALJ *ordered* the parties to engage in settlement negotiations in his April 5, 2011 remand order. CP 60. He also ordered the parties, as far as possible, to narrow the issues for hearing and to stipulate to exhibits and witnesses if the case could not be settled in total. CP 60. More than a year later, he again *ordered* the parties to engage in face-to-face settlement discussions. Settlement

negotiations finally occurred in early 2013, but *only after years of delay* caused by ESD's failure to comply with the ALJ's remand order.

ESD studiously avoids mentioning that the ALJ specifically remanded the Carriers' assessments for "further deliberation, reconsideration and new written audit findings" because he recognized a fundamental flaw in all of the audits; namely, the amounts imposed on the Carriers were wrong even if the Carriers were liable for additional taxes. CP 60, 333. ESD also ignores the obvious: *the ALJ*, not the Carriers, determined that the audits were so defective that they had to be remanded. Such a remand would never have occurred but for the defective quality of ESD's audits.¹

C. REPLY IN SUPPORT OF CROSS-APPEAL

(1) The Trial Court Abused Its Discretion by Failing to Sanction ESD and Its Counsel

¹ ESD attempts to blame the Carriers for the prolonged delay that occurred on remand by claiming they did not provide it with the information it needed to make the required adjustments. ESD br. at 29-30. This is simply *untrue*. ESD avoided taking any action on remand unless and until it became absolutely necessary for it to do so and then it did so only perfunctorily - all at the expenditure of considerable time and expense to the Carriers. CP 333. Although the Carriers provided ESD with detailed lists and supporting documentation on more than one occasion to identify the owner/operators they claimed should be excluded from the assessments based on the ALJ's remand order, ESD ignored it. CP 334. For example, System-TWT Transportation ("System") provided information to ESD in February 2012 that identified the owner/operators it claimed did not drive any miles in Washington. CP 344-61. System sent the information to ESD with a multi-page letter describing how the list of owner/operators was compiled and offering to produce *additional* documentation beyond that which it had already produced if ESD required anything further to complete the required adjustments. CP 344-46. ESD *never* requested the back-up documentation from System and for more than a year, *never even expressed the position* to System or to the ALJ that it needed the supporting documents to complete the adjustments. CP 334-35. *It simply did nothing.*

ESD engaged in bad faith by intentionally delaying the Carriers' administrative appeals and by attempting to repudiate the very agreement that it proposed and that the Carriers accepted to resolve those appeals. Carriers' br. at 46-50. ESD argues that the Carriers failed to show the trial court abused its discretion by declining to impose sanctions in this case. *Id.* at 24. ESD is mistaken. The trial court abused its discretion by failing to sanction ESD in light of its bad faith. *State v. Grayson*, 154 Wn.2d 333, 342, 111 P.3d 1183 (2005). ESD also argues that the Carriers waived the sanctions issue because they inadequately raised it and failed to properly preserve it below. ESD br. at 23. ESD is again mistaken. The Carriers raised the argument and supported it with authority.

(a) The Carriers established ESD's bad faith conduct

ESD agrees with the Carriers that attorney fees may be awarded as a sanction for bad faith as an equitable exception to the American Rule on attorney fees. ESD br. at 24; Carriers' br. at 47. But it argues that it did not engage in misconduct in this case and that the trial court thus properly denied the Carriers' request for sanctions. ESD br. at 24. Not so. ESD engaged in bad faith conduct that warranted the imposition of sanctions. The trial court abused its discretion by failing to sanction ESD.

Although ESD properly identifies the three types of bad faith that warrant the imposition of sanctions, ESD br. at 25, it misinterprets the Carriers' arguments supporting the award of sanctions here. ESD mistakenly contends both that the Carriers' request for sanctions is based on conduct forming the basis of the litigation and that the Carriers allege only prelitigation misconduct. *Id.* at 26. The Carriers believe that ESD engaged in dilatory pre-litigation misconduct,² but allege *for purposes of sanctions* that ESD engaged in procedural bad faith by renegeing on the agreement it proposed and they accepted to resolve their administrative appeals.³ Carriers' br. at 3, 46, 48.

ESD's nearly singular focus on prelitigation misconduct ignores the simple fact that that misconduct is already the subject of the Carriers' § 1983 lawsuit. The Carriers have alleged there that ESD exceeded its statutory authority by imposing inflated taxes on remuneration that it has no authority to tax and by unnecessarily prolonging the administrative

² Prelitigation misconduct refers to obdurate or obstinate conduct in bad faith that wastes private and judicial resources. *Rogerson Hiller Corp. v. Port of Port Angeles*, 96 Wn. App. 918, 927, 982 P.2d 131 (1999), *review denied*, 140 Wn.2d 1010 (2000) (citing Jane P. Mallor, *Punitive Attorneys' Fees for Abuses of the Judicial System*, 61 N.C.L. Rev. 613, 632 (1983)).

³ Procedural bad faith refers to vexatious conduct during the course of litigation, such as delaying or disrupting proceedings, and is unrelated to the merits of the case. *Rogerson*, 96 Wn. App. at 928.

process.⁴ They seek to recover the attorney fees and costs they expended defending against assessments now recognized as incorrect when issued.

ESD's limited focus ignores the more significant sanctions issue. Suffering from buyer's remorse, ESD tried to repudiate the agreement *it proposed* and the Carriers accepted. It engaged in procedural bad faith by conjuring frivolous reasons to avoid that settlement.

To avoid sanctions, ESD claims that its September 26, 2012 offer contemplated further negotiations to make the proposed settlement

⁴ *Nearly two years* were wasted trying to make sense of ESD's assessments. *ESD alone* caused the delay in resolving the Carriers' appeals. Its dilatory, prelitigation misconduct is undeniable in light of the following undisputed facts:

- In April 2011, the ALJ ordered ESD to issue amended audit findings and revised assessments that excluded owner/operators who lived out-of-state, were dispatched from out-of-state, and who drove no miles in Washington. CP 58-60.
- ESD revised its assessment a year later, in April 2012; however, it did not remove a single owner/operator on the basis of corporate form or situs outside of Washington. CP 334-35.
- On February 6, 2013, ESD submitted a list of owner/operators maintaining corporate forms, but did not revise any of the assessments to reflect any corresponding deductions. CP 334-35.
- On the same day, ESD *admitted* that it had not excluded any out-of-state owner/operators from the assessments. CP 328.
- Although ESD issued "re-determined" assessments nearly two years after the ALJ ordered it to reconsider them, it *admitted* that it did not produce official "revised assessments" that could be used for anything other than settlement negotiations. CP 130.

complete. ESD br. at 15. If that is the case, then ESD's offer was illusory.⁵ If not, then its offer was complete. As the Carriers recounted in their opening brief, ESD made a written settlement offer on September 26th. Carriers' br. at 14. Under traditional contract principles, ESD was free to prescribe as many conditions, terms or the like as it wished. *M.A. Mortenson Co. v. Timberline Software Corp.*, 140 Wn.2d 568, 590, 998 P.2d 305 (2000) (citing *Kroeze v. Chloride Group Ltd.*, 572 F.2d 1099, 1105 (5th Cir. 1978) (citations omitted)). ESD's proposal contained those terms that it presumably believed were the material terms required to resolve the Carriers' appeals. The Carriers accepted ESD's offer on October 8, 2012. Carriers br. at 15-16. With that agreement, the parties agreed to the final amount of each revised assessment, to the exclusion of penalties and interest, to the Carriers' payment of the revised assessments, to the Carriers' right to appeal, and to each party's responsibility for its own attorney fees and costs. CP 77-85. As master of

⁵ A supposed promise is illusory when its provisions make its performance optional or discretionary on the part of the claimed promisor. *Wharf Restaurant, Inc. v. Port of Seattle*, 24 Wn. App. 601, 609, 605 P.2d 334 (1979). See also, *Schuehle v. Schuehle*, 21 Wn.2d 609, 610, 152 P.2d 608 (1944) (noting an offer is illusory if it is so indefinite that a court cannot decide just what it means, and fix exactly the legal liability of the parties).

the offer, ESD clearly had the ability to condition its offer on further negotiations. But it *never* did so.⁶ CP 78-79.

ESD also seeks to avoid sanctions by claiming that it did not intend to be bound before the parties executed a formal settlement agreement. ESD br. at 17-20. Lacking Washington authority, ESD relies on *Zuker v. Katz*, 836 F. Supp. 137 (S.D.N.Y. 1993), ESD br. at 19, ignoring the impact of our Supreme Court's decision in *Condon v. Condon*, 177 Wn.2d 150, 298 P.3d 86 (2013).⁷ As the Carriers noted in their opening brief, ESD is seeking the exact same relief from this Court that our Supreme Court *rejected* in *Condon*. Carriers' br. at 39-40. It is attempting to imply the requirement of a formal written settlement agreement as a material term of the parties' settlement when that was *never* a part of the parties' agreement.

⁶ ESD suggests that emails between its former counsel, Marc Worthy, and the Carriers' counsel, Thomas Fitzpatrick, discussing the legal issues the Carriers could raise in court demonstrate that the parties contemplated further negotiations. ESD misstates the attorneys' exchange. ESD br. at 16 n.5. Worthy never stated that he believed the *only* legal issue the Carriers would pursue in the superior court was preemption. ESD br. at 16 n.5. Contrary to ESD's insinuation, Fitzpatrick's statement "I think so, Marc" answered Worthy's inquiry whether the parties could agree on the language to be used to address several issues raised in Worthy's email and not just the preemption issue. CP 85.

⁷ That the parties intended to be bound in advance of the formal agreement is evidenced by the Carriers agreement not to pursue their then-pending motions to compel and to strike penalties and interest. CP 47. ESD has not explained why, if the parties' exchange of correspondence was no more than an "agreement to agree," the Carriers would make this commitment.

While drafts of the agreement dated after the Carriers' October 8th acceptance letter address the formal document implementing the agreement, the subsequent refinements did not materially alter the parties' underlying agreement.⁸ Under basic contract law, ESD's offer and the Carriers' acceptance constituted mutual assent and created an enforceable agreement. *See* REST. (2D) CONTRACTS § 22. That ESD chooses to ignore well-known contract principles addressing the issue does exonerate it for its bad faith in attempting to avoid the settlement that it proposed.

ESD's actions throughout this case were in bad faith. ESD tried to manipulate the legal system to achieve its political and financial goals. Sanctions should have been imposed. The trial court abused its discretion by failing to decide the issue. *Grayson*, 154 Wn.2d at 342.

(b) The Carriers did not waive their argument that sanctions against ESD were appropriate

⁸ ESD characterizes the parties' exchange of various drafts of the formal settlement agreement after offer and acceptance as an "agreement to agree." ESD br. at 19. That argument is nonsensical. The Carriers wanted a resolution of issues in the administrative process (after 3 long years) so they could proceed to court on the merits of their argument that ESD's assessments were baseless. The fact that the parties contemplated drafting a formal settlement agreement sometime in the future does not mean that they intended to be bound *only* upon execution of that document. *Nowhere* in its offer did ESD so condition it. *Morris v. Maks*, 69 Wn. App. 865, 872, 850 P.2d 1357, *review denied*, 122 Wn.2d 1020 (1993). ESD's attempt to distinguish *Morris* is unpersuasive. ESD br. at 20. The *Morris* court held the parties to the material terms to which they agreed in an exchange of letters, despite the fact that they intended to draft a definitive or final settlement agreement. Although one of the parties claimed that he intended not to be bound until the final agreement was executed, his subjective intent was irrelevant where it was not expressed anywhere in the exchange of correspondence. *Id.* at 871.

ESD also argues that the Carriers allegedly waived their right to appeal the trial court's decision on sanctions because they raised the argument only in a footnote in their trial court brief.⁹ ESD br. at 23-24. ESD omits to note that the Carriers raised the sanctions issue and argued it *at length* in their motion for order to show cause. CP 9. This is not a case where there was only the passing treatment of an issue or the lack of reasoned argument.

ESD relies on *Washington Fed'n of State Employees, Council 28, AFL-CIO v. Office of Fin. Mgmt.*, 121 Wn.2d 152, 849 P.2d 1201 (1993) and *West v. Thurston County*, 168 Wn. App. 162, 275 P.3d 1200 (2012) to support its waiver argument. ESD br. at 23. But ESD's reliance on those cases is misplaced. In *Washington Federation*, two unions challenged the Office of Financial Management's ("OFM") decision to reject a "catch-up" wage salary increase for public employees proposed during a biennial budget cycle. 121 Wn.2d at 154. The trial court granted summary judgment to OFM and the unions appealed. *Id.*

On appeal, one of the unions alleged that OFM disapproved the pay increase solely for political reasons rather than because of its negative fiscal impact. *Id.* at 1625. It conceded that the pay increase did in fact

⁹ Ironically, ESD is guilty of the very thing of which it accuses the Carriers: its response brief is riddled with arguments raised in footnotes. *See, e.g.*, ESD br. at 8 n.3, 11 n.4, 30 n.11, 31 n.12.

have a “fiscal impact,” but claimed that impact was not the reason for OFM’s disapproval. *Id.* The Supreme Court declined to consider the union’s allegation, noting that the union had not adequately raised it below. In particular, the union’s motion opposing summary judgment *explicitly limited the issue presented to the trial court to whether OFM’s disapproval of the salary increase had been “piece-meal.”* *Id.* Furthermore, the trial court had pressed the union on the contentions regarding OFM’s motives to determine the extent of the factual allegations being raised. At the time, the other union expressly disclaimed the union’s fiscal impact allegation and it voiced no opposition to it. *Id.* at n.5. The Supreme Court therefore declined to consider the union’s allegation that OFM had no “fiscal impact” motive in disapproving the “catch-up” wage increase. In other words, there was affirmative evidence in the case that the complaining union had deliberately relinquished the issue.

In *West*, in Arthur West filed a public records lawsuit against Thurston County and the law firm defending it in an unrelated lawsuit. The trial court dismissed the lawsuit and West appealed. This Court affirmed in part, reversed in part, and remanded. *West*, 168 Wn. App. at 171-72. Following a hearing, the trial court imposed a penalty on the County and the law firm and awarded attorney fees to West. *Id.* at 177. He appealed again, asserting among other things that the trial court erred

by allowing and approving the County's assertion of over 300 public records exemptions. *Id.* at 178-80, 187.

This Court declined to consider West's exemptions challenge on appeal because he did not identify the exemptions in the record to which he referred nor did he provide any legal argument to support the alleged impropriety of the claimed exemptions. *Id.* As the Court noted, such "[p]assing treatment of an issue or lack of reasoned argument is insufficient to merit judicial consideration." *Id.* (quoting *Holland v. City of Tacoma*, 90 Wn. App. 533, 538, 954 P.2d 290, review denied, 136 Wn.2d 1015 (1998)).

Here, the Carriers did not raise one argument in the trial court and then attempt to raise a different one on appeal as occurred in *Washington Federation*. They presented a developed argument for the trial court's consideration, which the trial court inexplicably declined to decide.¹⁰ CP 38. Their request for sanctions was adequately raised and preserved in the trial court because the issue was presented to the trial court in both the Carriers' motion for an order to show cause and in their summary judgment motion. It was also the subject of a notice of cross-appeal.

¹⁰ ESD complains that the Carriers' cross-appeal is problematic because the trial court did not find that ESD engaged in conduct tantamount to bad faith. ESD br. at 24. That is the conundrum – the trial court did not explain why it declined to sanction ESD. The trial court, not the Carriers, created the problem the parties and this Court now face.

Moreover, the Carriers did not make a bald assertion in their memorandum that lacked factual and legal support as occurred in *West*. They unequivocally asserted that they were entitled to sanctions for ESD's bad faith conduct in the main body of their memorandum supporting enforcement of the parties' agreement. CP 38. They elaborated on and provided legal authority to support that argument in a footnote, much the same way this Court often cites authority for a specific legal proposition in a footnote. The Carriers' request was thus neither ambiguous nor equivocal whether the issue was truly intended to be part of their argument. This Court should reject ESD's attempt to dismiss their cross-appeal on procedural grounds.

(2) ESD's Appeal Is Frivolous

Sanctions are appropriate under RAP 18.9(a) because ESD has filed a frivolous appeal. It raised two claims in its brief: (1) that the trial court should not have resolved this case in a show cause proceeding; and (2) that no agreement existed between the parties. But it presents no debatable issues with respect to those claims. *Streater v. White*, 26 Wn. App. 430, 434–35, 613 P.2d 187, *review denied*, 94 Wn.2d 1014 (1980).

ESD's appeal has no basis in fact. ESD proposed an agreement to resolve the Carriers' administrative appeals that it disavowed after the Carriers accepted it. To avoid the agreement that it proposed, it makes the

baseless argument that there were additional “material terms” to the settlement *it proposed*. Plainly, it did not think such terms were material when it proposed the settlement. It could have required that the parties were not bound until they executed a formal written settlement agreement. It did not. *Condon* forbids the imposition of a new term ESD did not deem sufficiently “material” to include in its offer. ESD ignores clear authority outlined in the Carriers’ opening brief addressing “material terms” and relies upon easily distinguishable cases that do not even arguably support its position. The Carriers should be awarded their attorney fees on appeal for being forced to once again respond to meritless contentions concocted by ESD to avoid its own settlement proposal.

ESD’s appeal also has no basis in the law. ESD overlooks the statutory authority conferred on the trial court to proceed as it did. Under RCW 2.28.150, the trial court may structure the method to carry out its jurisdiction in *any way* that it wants. A show cause proceeding is one permissible way to carry out that statutory imperative. *Rogoski v. Hammond*, 9 Wn. App. 500, 504, 513 P.2d 285 (1973). ESD received all the process that it was due – it received notice and a fair hearing before an impartial decision-maker. Its argument with respect to the show cause procedure is groundless.

ESD also attempts to undermine Washington's strong public policy favoring settlements and stipulations over needless litigation. *See, e.g., City of Seattle v. Blume*, 134 Wn.2d 243, 258, 947 P.2d 223 (1997) (“[T]he express public policy of this state . . . strongly encourages settlement.”).

Finally, ESD claims that it seeks expeditious resolution of its appeal and thus on the underlying tax assessments. ESD br. at 33. What ESD actually seeks is *seven separate administrative hearings* on the amount of the assessments allegedly owed by the Carriers in lieu of the settlement agreement that it proposed and that the Carriers accepted nearly a year ago to resolve their administrative appeals. There is nothing expeditious about such an outcome. Furthermore, ESD neglects to mention that in addition to trying unsuccessfully *three times* in this Court to stall consideration of the Carriers' petition for judicial review on the merits of the assessments in Spokane County Superior Court, it also attempted to continue that proceeding in that court pending this Court's resolution of its appeal. ESD's conduct throughout this case belies its claim that it seeks an "expeditious" resolution to the parties' dispute.

Like the many motions that preceded it, the purpose of ESD's appeal is not to present a colorable legal argument, but to drive up the Carriers' attorney fees and costs. ESD's appeal is frivolous and brought

solely for purposes of delay. ESD should pay the Carriers' attorney fees on appeal pursuant to RAP 18.9(a).

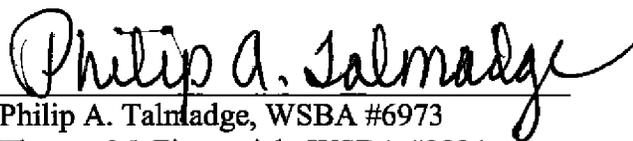
D. CONCLUSION

The Carriers' appeals languished in the administrative process for years because of ESD's foot-dragging and obstructionist behavior. After the parties resolved their protracted dispute, ESD had second thoughts. Its attempt to create frivolous reasons to avoid the settlement *it proposed* constitutes bad faith for which it should have been sanctioned. The trial court abused its discretion by failing to sanction ESD.

This Court should reverse the trial court on only that issue and remand for entry of an order imposing attorney fees and costs on ESD for its bad faith conduct at trial. Sanctions on appeal pursuant to RAP 18.7/RAP 18.9(a) should be imposed against ESD.

DATED this ~~11th~~ day of September, 2013.

Respectfully submitted,



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DECLARATION OF SERVICE

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

DATED: September 11, 2013 at Tukwila, Washington.



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