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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

LISA STEEL, individually and as Guardian *ad litem* for J.T., a minor;
DOUGLAS THOMPSON and KRISTI BARBERI, individually and as
Guardian *ad litem* for S.R.B., a minor,

Appellants/Plaintiffs

v.

OLYMPIA EARLY LEARNING CENTER, et al.,

Respondents/Defendants

v.

PHILADELPHIA INDEMNITY INSURANCE COMPANY

Respondent/Intervenor

BRIEF OF RESPONDENT

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I. INTRODUCTION

Since September 2012, Appellants have attempted to block Intervenor/Respondent Philadelphia Indemnity Insurance Company (“Philadelphia”) from obtaining relevant discovery regarding the reasonableness of stipulated settlements Appellants entered into with Philadelphia’s insureds related to three lawsuits against the Olympia Early Learning Center (“OELC”) (the named insured) and three separate lawsuits against two of OELC’s management employees (who are also insureds).¹ Philadelphia appointed counsel and provided a defense to Defendants throughout the course of the lawsuits.

In September 2012, before either side had completed discovery in the lawsuits, Defendants agreed to stipulate to the entry of judgments totaling \$25 million and to assign claims against Philadelphia in exchange for full releases of all claims. The stipulated judgments were supported by factual “confessions” signed by the Defendants. These factual “confessions” contradicted Defendants’ prior statements and testimony, police and DSHS reports, and defense counsel’s reports. Moreover, the settlement amount was 25 times defense counsel’s earlier valuation of the case.

¹ As used herein, the term “Defendants” denotes Philadelphia’s insureds who are defendants in the consolidated lawsuits – OELC, Steven Olson and Rose Horgdahl. “Appellants” denotes the plaintiffs who sued the insureds and are now appealing the trial court’s orders. The Appellants include adult plaintiffs and minor plaintiffs.

In late 2012, the trial court ruled that, despite many irregularities in the stipulated settlements, the court would conduct a reasonableness hearing, but only after Philadelphia had the opportunity to conduct limited focused discovery.

The discovery Philadelphia requested in 2012, which included the depositions that are the subject of this appeal, could have been completed within a few months. However, Appellants delayed the production of documents and the scheduling of depositions, took extreme positions, refused to compromise, and re-litigated discovery issues again and again.

In late 2013, the Court of Appeals granted review of a narrow issue related to attorney-client privilege and work product protection related to one discovery order.

On return to the trial court,² the discovery disputes resumed. In June 2017, consistent with Washington law, including the ruling of the Court of Appeals in the first interlocutory review, Judge Dixon properly exercised his discretion to allow Philadelphia a small window to complete limited deposition discovery focused on the *Glover* reasonableness factors (“Reasonableness Factors”) he will consider in evaluating the settlements.³

² There have been three trial judges in this matter: First Judge McPhee, then Judge Price and finally Judge Dixon.

³ *Glover v. Tacoma General Hospital*, 98 Wn.2d 708, 717, 658 P.2d 1230 (1983).

During the same hearing, Judge Dixon ruled that the adult plaintiffs were not entitled to a reasonableness hearing because the settlement agreements fully released their claims against the insureds.⁴ Judge Dixon's decision is consistent with *MOE v. Day*,⁵ which held that a stipulated judgment agreement that fully insulates the insured from liability for the agreed judgment is not effective for the purpose of establishing damages for a later bad faith action against the settling defendant's insurer.⁶

Like the settlement agreements in *MOE v. Day*, the settlement agreements in this case fully release the Defendants from liability. Thus, proceeding with a reasonableness hearing as to the adult plaintiffs' claims would be a waste of judicial resources. Further, the dismissal of the adult plaintiffs' claims merely means the assigned claims must be proven in the damages phase of separate bad faith litigation.

The trial court did not abuse its discretion by allowing Philadelphia limited, focused deposition discovery related to the reasonableness of the stipulated settlements and properly declined to include the adult plaintiffs' claims in the reasonableness proceedings.

⁴ The minor settlements have not been approved by a trial court yet. Accordingly, Philadelphia did not argue that its insureds are fully released by the minor settlements.

⁵ *Mut. of Enumclaw Ins. Co. v. Myong Suk Day*, 197 Wn. App. 753, 393 P.3d 786 (2017), review denied, 188 Wn.2d 1016 (“*MOE v. Day*”).

⁶ *MOE v. Day*, 197 Wn. App. at 757.

II. STATEMENT OF THE CASE

A. Overview

This is the second interlocutory appeal challenging trial court discovery orders related to reasonableness. The Court of Appeals' prior decision was limited to plaintiff counsel's privilege under the implied waiver doctrine.⁷ It did not bar Philadelphia from deposing defense counsel or other witnesses. Indeed, the prior decision affirmed that deposition discovery was within the trial court's discretion. CP 3156.

In January 2017, after the first appeal, when this matter was returned to the trial court, Philadelphia was ready to resume discovery already ordered by the trial court, the deposition of defense counsel, and to resolve the remaining discovery issues. However, plaintiff counsel continued to obstruct discovery and another round of discovery disputes ensued. CP 3014; CP 5359.

On May 19, 2017, after extensive briefing by both parties and multiple discovery hearings, Judge Dixon properly exercised his discretion to allow limited deposition discovery related to the Reasonableness

⁷ *Steel v. Philadelphia Indem. Ins. Co., et al.*, 195 Wn. App. 811 (2016)

Factors (discussed below) the court will ultimately consider in evaluating the reasonableness of the stipulated settlements⁸. CP 7849.

At the same hearing, based upon Division I's December 12, 2016 *MOE v. Day* decision, Judge Dixon revisited a portion of Judge McPhee's ruling early in the reasonableness phase. VRP 7:8-16; VRP 14:11. Judge Dixon agreed with Philadelphia that it was pointless to conduct a reasonableness hearing related to the adult plaintiffs' claims because a reasonableness determination would not be used as the measure of damages in any subsequent litigation. CP 7852; VRP 14:11-14.

B. The Pre-Settlement Phase of Litigation and the Interpleader Action

In late 2011 and early 2012, Appellants filed six lawsuits against Defendants alleging that OELC and two managerial employees were negligent in hiring and supervising a former employee. Philadelphia provided a complete defense to Defendants, never disputed coverage, defended without reserving rights, and offered its policy limits to resolve the claims. CP 3063.

On February 21, 2012, appointed defense counsel Michael Bolasina ("Defense Counsel") sent a report to Philadelphia stating, among other things: 1) that five of the six claims were nuisance claims; 2) that

⁸ The court issued an oral ruling at the May 19, 2017 hearing and entered the corresponding written order on June 22, 2017.

plaintiff counsel had done little to establish liability or damages in *any* of the claims; and 3) that the one non-nuisance claim might be worth about \$1 million. CP 3818.

During this pre-settlement phase, the individual defendants testified in deposition that the employee had cleared two background checks and that they had no knowledge of any misconduct occurring at OELC. CP 3655 – 3659; CP 3661 – 3662.

A dispute developed between *plaintiff* counsel and Philadelphia regarding the amount of available insurance limits, with plaintiff counsel insisting that there were \$4 million in limits. On August 24, 2012, after plaintiff counsel refused to engage in mediation, Philadelphia filed a separate interpleader action in federal district court asking that court to determine the amount of the applicable policy limits and then to distribute those limits. CP 2805. The federal court ultimately ruled in Philadelphia’s favor: “the limit of insurance available for bodily injury arising from multiple claims of abuse over multiple policy periods is exactly and only \$1 million.”⁹

However, by the time of the federal court’s ruling, the parties had already entered into the stipulated settlements and, despite the fact that the federal court decision affirmed Philadelphia’s position that the available

⁹ *Philadelphia Indem. Ins. Co. v. Olympia Early Learning Ctr.*, 980 F. Supp. 2d 1266, 1273 (W.D. Wash. 2013).

policy limits are \$1 million, Appellants continued to seek a reasonableness determination.

C. The Stipulated Settlements

On August 29, 2012, just days after Philadelphia filed the interpleader action, despite the complete lack of evidence that any plaintiff child was abused at the learning center/daycare and despite little known evidence to support his clients' damages, plaintiff counsel sent a two page letter to defense counsel asking Defendants to stipulate to judgments totaling \$25 million. CP 3914-3915. Twelve separate settlement agreements — one settlement agreement for each of the 6 children and separate agreements for each child's parent(s) — were attached. Each of the draft agreements provided for the "full release[] and discharge [of] Defendants from any and all of Plaintiff's claims, causes of action, damages...based on acts or omissions which are alleged or could have been alleged in the lawsuit." CP 3917 – 4025. Plaintiff counsel sent two subsequent drafts, but the release language remained the same in each. CP 4027 - 4138; CP 4140; CP 4142 - 4347. Other than a single request by OELC's counsel to include OELC in the covenant not to execute, the Release Agreements were drafted solely by the Appellants and were not negotiated with the Defendants. CP 478.

On September 19, 2012, Defense Counsel conveyed a \$1 million settlement offer, funded by Philadelphia. CP 3664 - 3665.

On September 24, 2012, less than one week after the \$1 million limits of the Philadelphia policies had been offered, Defendants stipulated to entry of judgments totaling \$25 million. CP 470; CP 3828.

Philadelphia was shocked by the extremely inflated amount and that the stipulated settlements were supported by factual “confessions” signed by Defendants, which included apparently false admissions that each of the children had been abused at the learning center/daycare and by other apparently false admissions. CP 1922.

Each of the adult plaintiff settlement agreements was signed by the adult plaintiff whose claims were the subject of the release. CP 768 - 769; CP 834 - 835; CP 902 - 903; CP 924 - 925; CP 990 - 991. Each settlement agreement fully released all claims by the respective adult plaintiff against Defendants pursuant to a release provision (which had remained unchanged in every draft of the release agreements):

“5. Release. Upon full execution of this Agreement by all parties, Plaintiff forever releases and discharges Defendants from any and all of Plaintiff’s claims, causes of action, damages, debts, expenses, costs, attorneys’ fees, and other taxable costs, and any other demands of whatsoever kind, nature or description, whether past, present or future,

known or unknown, and based on acts or omissions which are alleged or could have been alleged in the lawsuit.”¹⁰

In addition, each settlement agreement states, in pertinent part:

2. ... Should a Court determine that an amount other than the amount of the stipulated judgment is a reasonable settlement amount, Plaintiff and Defendants agree to stipulate to a judgment against Steve Olson, Rose Horgdahl, and the Olympia Early Learning Center in that amount . . . ¹¹

By their terms, the adult plaintiffs’ releases were **not** contingent on a finding of reasonableness **nor** were they contingent on the results of a subsequent bad faith claim. Accordingly, a reasonableness determination will have **no** effect on the full and complete release of Defendants. The release agreements also state that the provisions therein are fully severable, further supporting the non-contingent nature of the complete release of claims. CP 4349 - 4666.

Shortly after the settlement, Defendants produced to plaintiff counsel the complete, un-redacted files of Defense Counsel and of personal counsel for Defendant Olson, William Ashbaugh, including attorney-client communication and mental impression work product, thus waiving any attorney-client and work product privilege of the Defendants. CP 3879; CP 4675; CP 4915.

¹⁰ CP 4349 - 4666

¹¹ *Id.*

As part of the settlement, plaintiff counsel now “represents both Plaintiffs and Defendants in seeking a reasonableness determination concerning the settlement.” CP 2399. In his capacity as counsel for both Appellants and Defendants, plaintiff/defense/appellant counsel has instructed Defense Counsel not to discuss substantive issues related to this matter with Philadelphia. CP 1303. Thus, Philadelphia’s only opportunity to learn what Defendants knew at that the time of the settlement regarding liability, damages, and other factors that will be considered by the trial court, is through deposition testimony of defense counsel and the Defendants.

D. The Reasonableness Phase

After Philadelphia learned of the settlements, Philadelphia’s coverage counsel reached out to plaintiff counsel to discuss a stipulation to allow Philadelphia to intervene and a plan for focused discovery related to reasonableness. CP 78 - 79. Rather than agreeing to allow Philadelphia to conduct limited, focused discovery, however, plaintiff counsel argued that Philadelphia should not be permitted to conduct any discovery. CP 82 - 83; CP 108 - 109.

On October 26, 2012, the trial court heard oral argument on Philadelphia’s Motion to Intervene and Conduct Focused Discovery. During oral argument, Judge McPhee *sua sponte* asked plaintiff counsel

whether the court was even required to conduct a reasonableness hearing under the circumstances of this case:

Mr. Cochran, why don't I just tell you to go away, that I'm not going to do a reasonableness hearing? ...

* * *

So what is there to accomplish here? Why don't I just tell you to go away, the [interpleader] action can be completed, see what liability the insurance company has. If it's \$4 million policy and a million dollar offer, then you have got a bad faith claim and then you can litigate the binding effect of that settlement in a case where you've got two sides and they're in a traditional adversary litigation posture.¹²

After hearing from both sides on this issue, Judge McPhee requested briefing on whether the court was required to conduct a reasonableness hearing.¹³ In the meantime, Judge McPhee granted Philadelphia's Motion to Intervene. CP 519 - 522.

On November 9, 2012, after noting that Washington courts provided little guidance regarding whether a reasonableness hearing should be conducted, Judge McPhee determined that a reasonableness hearing would be conducted. CP 1383-1384. However, during that hearing, Judge McPhee rejected Appellants' argument that Philadelphia should be forced to proceed without the discovery it needs to participate on equal footing in a court proceeding that will examine the nine Reasonableness Factors the trial will use to determine the reasonable value

¹² 10/26/12 revised and corrected verbatim report, 16:19-21; 17: 10-18.

¹³ 10/26/12 revised and corrected verbatim report, 33: 10-13

of Appellants' claims. Specifically, Judge McPhee ordered phased discovery as follows:

- (1) Phase One - Plaintiffs are required to turn over documents to Philadelphia.
- (2) Phase Two - After the completion of document discovery, a meeting/conference between the court and counsel will be scheduled to address what additional discovery Philadelphia requests (*e.g.*, deposition discovery).

Appellants continued their efforts to deny Philadelphia discovery related to the Reasonableness Factors. On March 13, 2013, Appellants filed a Motion Requesting a Special Set Hearing to Enter Judgment. CP 1239 - 1259.

During an April 19, 2013 hearing, Philadelphia's counsel stated that Philadelphia sought to depose: 1) any reasonableness experts that the Appellants plan to rely upon; 2) counsel; 3) the adult plaintiffs; 4) Defendants; and 5) Settlement Guardians Ad Litem ("SGALs").¹⁴ Thus, contrary to Appellants' assertions, the scope of discovery requested by Philadelphia has remained consistent; it has not expanded.

¹⁴ 4/19/13 Verbatim Transcript of Proceedings, 36:18-37:4.

During the hearing, plaintiff counsel said he agreed that Philadelphia should be able to depose the lawyers who were involved in the settlement and the reasonableness experts.¹⁵

The trial court ruled that Philadelphia could depose the lawyers and any experts on reasonableness (CP 2229) and that he was “leaning towards permitting [the depositions of] those who signed the declaration supporting the settlement,” meaning the individual defendants and OELC’s CEO John Masterson.¹⁶ The trial court held that attorney depositions could commence, and directed Philadelphia to note a motion regarding additional discovery after Phase 1 document discovery was completed.¹⁷

Philadelphia proceeded to schedule the attorney depositions. Personal counsel for defendant OELC, Paul Meyer, and for defendant Olson, William Ashbaugh, were deposed. However, before Philadelphia had the opportunity to depose plaintiff counsel and Defense Counsel, Appellants filed a Motion Re the Deposition of Darrell L. Cochran and Quash Subpoena which, among other things, asked the court to limit the scope of plaintiff counsel’s deposition.

¹⁵ 4/19/13 Verbatim Transcript of Proceedings at 37:5-37:6

¹⁶ 4/19/13 Verbatim Transcript of Proceedings, 37:5-15.

¹⁷ 4/19/13 Verbatim Transcript of Proceedings, 37:16-38:3.

On November 22, 2013, after both sides filed additional discovery motions, the trial court issued two orders: 1) an Order Re Intervenor’s Motion to Compel and Special Discovery Master’s Recommendations, which compelled Appellants to produce all documents designated by the special discovery master as not protected (“Order Compelling Production”); and 2) an Order Denying Plaintiff’s Motion Re the Deposition of Darrell L. Cochran and Quash Subpoena (“Order Denying Protective Order”). CP 4961 – 4962; CP 6927- 6928.

E. The First Appeal

Appellants sought discretionary review of both November 22, 2013 orders. The Court of Appeals declined review of the Order Denying Protective Order. The Court of Appeals did grant review of the Order Compelling Production, but only on the narrow question of whether entering into a settlement waives the attorney-client and mental impression privileges.

During oral argument before the Court of Appeals in *Steel v. Philadelphia Indem. Ins. Co.*, 195 Wn. App. 811, 381 P.3d 111 (2016) (“*Steel I*”) the Court asked Philadelphia’s counsel the following question:

... couldn’t you go and call all the victims to the stand and their parents and call the defendants to the stand and ask them what they know? I mean why -- I am not understanding what the attorney’s mental impressions and communications with their clients, what information that

you really needed to determine if the settlement was reasonable.¹⁸

On July 26, 2016, the Court of Appeals held Appellants had not waived privilege,¹⁹ noting that Philadelphia can obtain information it needs by other means, including deposing plaintiffs:

Philadelphia can depose the plaintiffs to determine the strength of the abuse allegations in order to evaluate the settlement amount and the validity of the supporting confessions.²⁰

Then, on October 4, 2016, after Appellants moved for reconsideration on this issue, the Court of Appeals ruled:

[A]t the trial court's discretion, Philadelphia can depose the plaintiffs to determine the strength of the abuse allegations in order to evaluate the settlement amount and the validity of the supporting confessions.

CP 7450.

On December 2, 2016, before this matter was returned to the trial court, Philadelphia's counsel reached out to plaintiff counsel seeking to coordinate remaining previously ordered discovery and other discovery issues. CP 5445 - 5447. Plaintiff counsel rejected this overture. CP 5449. On January 6, 2017, plaintiff counsel moved to set the reasonableness hearing and disallow any discovery by Philadelphia. CP 3014 - 3032.

¹⁸ *Steel v. Olympia Early Learning Center*, (Page 15:6 to 15:11).

¹⁹ *Steel v. Philadelphia Indem. Ins. Co.*, 195 Wn. App. 811, 381 P.3d 111 (2016).

²⁰ *Id.* at 838.

On January 27, 2017, Judge Dixon ruled that Philadelphia may depose the Defendants, adult plaintiffs, and SGALs regarding the Reasonableness Factors. CP 4773 – 4774. Judge Dixon explained that his discovery ruling was “consistent with the rulings that have been entered thus far in the case,” including those of the Court of Appeals in *Steel I. Id.* This discovery was delayed, however, because plaintiff counsel ignored Philadelphia’s repeated requests to cooperatively schedule the depositions. CP 5244; CP 5462 – 5463; CP 5465 – 5466; CP 5468 -5469.

The parties finally managed to schedule the deposition of Defense Counsel (pursuant to Judge Price’s prior order), but, when Philadelphia’s counsel asked Defense Counsel a question related to liability and damages, plaintiff counsel demanded the deposition be continued. CP 7050. Appellants then filed another motion to end discovery and set the reasonableness hearing. CP 5325; CP 5361.

On April 7, 2017, on Appellants’ motion, Judge Dixon again granted “[d]epositions of the adult plaintiffs, the defendants, settlement GALs and the parties’ respective reasonableness experts” and ordered the reasonableness hearing to occur before the end of June 2017. CP 7013. Philadelphia continued to attempt to schedule the ordered depositions. CP 7775.

The first deposition, that of OELC's CEO John Masterson, began on April 28, 2017. CP 7211 - 7239. Instead of Defense Counsel representing Mr. Masterson, plaintiff counsel acted as Mr. Masterson's counsel. Plaintiff counsel stymied the deposition by instructing Mr. Masterson not to answer questions regarding the Reasonableness Factors (based on relevance and other improper grounds). *Id.* The deposition was continued and Philadelphia went back to the trial court for direction.²¹

On May 5, 2017, Judge Dixon instructed Philadelphia to submit a list of the individuals it wished to depose, and, in general terms, the questions it wished to ask these witnesses related to the Reasonableness Factors. VRP 9:3-12. Philadelphia provided briefing detailing the areas of inquiry it sought for each witness, explaining their relationship to the nine Reasonableness Factors (CP 7504), which are: (1) the releasing person's damages; (2) the merits of the releasing person's liability theory; (3) the merits of the released person's defense theory; (4) the released person's relative faults; (5) the risks and expenses of continued litigation; (6) the released person's ability to pay; (7) any evidence of bad faith, collusion, or fraud; (8) the extent of the releasing person's investigation and preparation of the case; and (9) the interests of the parties not being released.²²

²¹ *Id.*

²² *Glover v. Tacoma Gen. Hosp.*, 98 Wn.2d 708, 717, 658 P.2d 1230 (1983).

On June 22, 2017, the trial court issued an order permitting some, but not all, of the requested deposition discovery on limited topics pertaining to the Reasonableness Factors. CP 7849 - 7851. The court ordered that: 1) “[Defense Counsel] may be deposed with respect to risk of litigation, preparation for trial, and his opinion regarding liability” (Factors 2, 3 and 5); 2) Defendants “may be deposed with respect to defendant’s ability to pay or contribute to settlement or the judgment, and in their opinion, the veracity of the factual confessions” (Factors 4, 6, and 7); 3) the adult plaintiffs “may be deposed with respect to facts necessary to evaluate both liability and damages known by plaintiffs at the time of settlement” (Factors 1 and 2); 4) the SGALs “may be deposed with respect to circumstances regarding their retention, how they were retained, by whom, what the process was, what information was provided to them, whether they were influenced, for lack of a better term, by either, both, or any counsel regarding their reports”²³ (Factor 7); and 5) “[plaintiff counsel] will not be deposed.” VRP 40:5-41:3.

At the same hearing, the trial court also issued its order granting Philadelphia’s Motion to Dismiss, regarding the claims of the adult

²³ The Trial Court reserved on the issue of whether any evidence obtained from depositions of the SGALs would be admissible at the reasonableness hearing. CP 5485 - 5486.

plaintiffs. CP 7852 - 7853. Appellants appealed both Orders. CP 7854 - 7856.

III. ARGUMENT

A. The Trial Court Properly Exercised Its Discretion to Permit Discovery

1. The Standard of Review

Discovery within the context of a reasonableness hearing, as in any litigation, is governed by CR 26.²⁴ Intervening parties have the same rights as any other party to the litigation, including the right to seek discovery.²⁵ The procedures for handling the reasonableness hearing, including discovery, are within the trial court's discretion.²⁶ Further, a trial court's discovery orders are reviewed for abuse of discretion.²⁷ "A trial court

²⁴ See *Steel I* at 822 ("CR 26 allows discovery regarding any nonprivileged matter relevant in a pending action.")

²⁵ *In re Custody of C.C.M.*, 149 Wn. App. 184, 198, 202 P.3d 971 (2009) (intervening party must be allowed to fully participate in litigation including the right to examine witness).

²⁶ *Brewer v. Fibreboard Corp.*, 127 Wn.2d 512, 524, 901 P.2d 297 (1995) ("The trial judge faced with this task [of determining reasonableness] must have discretion to weigh each case individually."); *Bird v. Best Plumbing*, 175 Wn.2d 756, 774-75, 287 P.3d 551 ("Trial courts retain broad discretion in determining reasonableness, and we review under an abuse of discretion standard"); *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 159, 795 P.2d 1143 (1990) ("we are confident that trial judges will develop their own procedures for handling these cases"); *Pickett v. Stephens-Nelsen, Inc.*, 43 Wn. App. 326, 335, 717 P.2d 277 (1986) ("the procedures for handling evidence at these hearings are within the trial court's discretion.").

²⁷ *Id.* ("We also review a trial court's discovery orders for abuse of discretion.")

abuses its discretion when its decision is *manifestly unreasonable* or is based on *untenable grounds or untenable reasons*.²⁸

2. Reasonableness Hearings Guard Against Excessive Judgments

The Court of Appeals adopted the statutory reasonableness determination to evaluate covenant judgment settlements in *Chaussee v. Maryland Casualty Co.*²⁹ The *Chaussee* Court adopted the Reasonableness Factors set out by the Washington Supreme Court in *Glover v. Tacoma General Hospital*,³⁰ which are listed above.

These factors protect the insurer from fraud and collusion between the insured defendant and injured plaintiff in the covenant judgment context just as they protected non-settling, joint-tortfeasor defendants in the contribution context.³¹

Washington law recognizes that the *only* purpose of the covenant judgment is to attempt to establish damages that an insurer may be required to pay in an assigned bad faith claim.³² Consequently, Washington appellate courts have repeatedly cautioned trial courts to be aware that Washington law regarding covenant judgments provides the

²⁸ *Water's Edge Homeowners Ass'n v. Water's Edge Associates*, 152 Wn. App. 572, 584, 216 P.3d 1110, 1117 (2009) (emphasis added).

²⁹ 60 Wn. App. 504, 509–10, 803 P.2d 1339 (1991).

³⁰ 98 Wn.2d 708, 717, 658 P.2d 1230 (1983).

³¹ *Bird v. Best Plumbing Grp., LLC*, 175 Wn.2d 756, 781, 287 P.3d 551, 564 (2012).

³² *See Werlinger v. Wagner*, 126 Wn. App. 342, 350-351, 109 P.3d 22, 27 (2005) (“the sole purpose of the covenant judgment [is] to serve as the presumptive measure of damages in a separate bad faith lawsuit.”).

settling parties with a financial incentive for collusion and inflated settlements designed to obtain windfalls from insurance companies. The Washington Supreme Court recognized from the beginning, when it established the reasonableness hearing procedure, that a covenant not to execute inherently raises the “specter” of insurance fraud or collusion.³³

The Court of Appeals has similarly warned that:

an insured may settle for an inflated amount to escape exposure and thus call into question the reasonableness of the settlement. We share this concern about consent judgments coupled with a covenant not to execute.³⁴

Washington appellate courts have advised trial courts conducting a reasonableness hearing to examine the information available to each party related to eight express factors that ordinarily bear on a claim’s value (*e.g.*, liability and damage evidence) and, in addition, expressly cautioned the trial court to affirmatively look for “any evidence” of “bad faith, collusion or fraud”³⁵ Washington appellate courts have clearly, expressly and intentionally given the trial courts great latitude regarding how to apply

³³ *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002).

³⁴ *Chaussee*, 60 Wn. App. at 510-11.

³⁵ *See Bird*, 175 Wn.2d at 766 (reasonableness hearing protects the interest of insurers against excessive judgments; trial court required to evaluate reasonableness based upon Reasonableness Factors including whether there is any evidence of bad faith, collusion, or fraud”); *see also Besel*, 146 Wn.2d at 738 (application of the *Glover* criteria “promotes reasonable settlements and discourages fraud and collusion.”).

the Reasonableness Factors and how to conduct a reasonableness hearing.³⁶

3. Trial Court Discretion Regarding Discovery Guards Against Inflated Settlements

The seminal case of *Water's Edge Homeowners Ass'n v. Water's Edge Assocs.*,³⁷ dramatically demonstrates why trial courts must have discretion to permit insurers to conduct discovery prior to a reasonableness hearing. In *Water's Edge*, the Court of Appeals affirmed the trial court's reasonableness determination, which relied primarily on the testimony of defense counsel, to find that an \$8.75 million stipulated judgment amount was unreasonable, and that the reasonable settlement value would have been \$400,000.³⁸ Information obtained through depositions of defense counsel by the intervening insurer was critical to the trial court's ruling. CP 6989-6990. The *Water's Edge* trial court strongly considered defense counsel's opinions regarding the strengths and weaknesses of the plaintiffs' claims:

³⁶ *Brewer v. Fibreboard Corp.*, 127 Wn.2d 512, 524, 901 P.2d 297 (1995) ("The trial judge faced with this task [of determining reasonableness] must have discretion to weigh each case individually."); *Bird*, 175 Wn.2d at 774-75 ("Trial courts retain broad discretion in determining reasonableness, and we review under an abuse of discretion standard"); *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 159, 795 P.2d 1143 (1990) ("we are confident that trial judges will develop their own procedures for handling these cases"); *Pickett v. Stephens-Nelsen, Inc.*, 43 Wn. App. 326, 335, 717 P.2d 277 (1986) ("the procedures for handling evidence at these hearings are within the trial court's discretion.").

³⁷ 152 Wn. App. 572, 585, 216 P.3d 1110, 1118 (2009).

³⁸ *Water's Edge*, 152 Wn. App. at 580.

[Defense counsel] felt confident in his ability to win dismissal of the challenges to the public offering statement and felt very confident in his ability to win dismissal on the breach of contract claim against KPS because there was no written contract.³⁹

In *Water's Edge*, the trial court also gave strong consideration to defense counsel's evaluation of the settlement value of the plaintiffs' claims:

[Defense counsel] estimated that there was a less than 20 percent chance of a jury verdict in excess of \$1 million. [Defense counsel] concluded that if the parties took the case to trial, the damages would likely be in the \$300,000 range, not the \$3 million range. Accordingly, he advised Associates and KPS that the case had a verdict range of between \$200,000 and \$500,000 and he advised [the insurer] that there was a likely settlement value of between \$250,000 and \$350,000.⁴⁰

The Court of Appeals agreed. Division II affirmed the trial court's ruling that the settlement was unreasonable and further found that the trial court did not abuse its discretion when it found that \$400,000 would have been a reasonable settlement amount.

Moreover, Division II found the trial court's consideration of evidence the insurer obtained through discovery regarding the value of the claim to be entirely proper:

[T]he trial court gave great weight to [Defense counsel]'s analysis, concluding that if this were an arm's length negotiation between the parties, with the parties having to

³⁹ *Water's Edge*, 152 Wn. App. at 588.

⁴⁰ *Id.*

spend their own money to pay damages, the settlement amount would not come close to \$8.75 million and, instead, would be closer to [Defense counsel]'s exposure estimate of \$500,000 The trial court properly considered the [Plaintiff's] potential damages award and did not abuse its discretion by failing to adopt the [Plaintiff's] arguments that they could possibly recover more.⁴¹

In *Water's Edge*, evidence gathered through discovery by the insurer after the stipulated settlement was a significant factor in the trial court's reasonableness determination. Division II summarized the facts the trial court considered in evaluating factor 7, bad faith, collusion, or fraud:

...The trial court indicated that the way that the case shifted abruptly from litigation to collaboration was highly suspect and troublesome. The trial court was clearly bothered by the overall structure of the settlement here; that of a joint effort to create, in a nonadversarial atmosphere, a resolution beneficial to both parties, yet highly prejudicial to Farmers as intervenor.

The trial court found the following circumstances troubling: (1) counsel for the HOA contacted Associates and KPS, adverse parties, without notice to [defense counsel], wrote a ghost letter for Associates and KPS to send to Farmers critical of [defense counsel], and recommended that Associates and KPS contact Beal and Harper for independent representation; (2) coverage counsel undermined [defense counsel]'s efforts to reduce [defendant's] exposure, presumably by withdrawing [defense counsel]'s pending summary judgment motion regarding the HOA's remaining claims; (3) the parties realigned their interests by stipulating that Associates and KPS could recover their \$215,000 contribution if the HOA prevailed in its malpractice and bad faith case; (4) the parties appeared to have a joint venture type relationship in

⁴¹ *Water's Edge*, 152 Wn. App. at 588–89.

which the HOA agreed to kick back some of the proceeds from any recovery from Farmers or [defense counsel]’s firm; (5) Beal insisted that the settlement be binding, regardless of the trial court’s reasonableness determination; and (6) neither [defendant] had any reason to care what dollar amount they agreed to, so long as they could sell it to the trial court as reasonable.⁴²

Division II held that based upon this evidence, evidence obtained through post settlement discovery, “[T]he trial court did not err by finding evidence of collusion here.”⁴³

4. Reasonableness Is Determined by What Was Known by Both Parties at the Time of Settlement

Reasonableness is determined by what information was known by the parties at the time of settlement, not what was known to a defendant’s insurer at the time of settlement.⁴⁴ Appellants’ argument that discovery is “frozen in time” at the moment of settlement is a red herring. It confuses the process of discovering the information the parties knew at the time of settlement, as permitted under the trial court’s order here, with the introduction of the parties’ post-settlement knowledge, which is not sought here by Philadelphia. The discovery ordered by the trial court is limited to questions about what was known by the parties at the time of the settlement, which, as illustrated by *Water’s Edge*, is regularly permitted in the reasonableness hearing context.

⁴² *Water’s Edge*, 152 Wn. App. at 594–96.

⁴³ *Id.*

⁴⁴ *See Bird*, 175 Wn.2d at 775-76.

Appellants argue that Philadelphia should be denied access to witnesses because Philadelphia had been participating in the defense of the case and therefore should already have the information it needs to address the reasonableness of the settlements. OB at 51-53. This argument ignores the fact that the settlement occurred before the adult plaintiffs and other key witnesses were deposed and the fact Philadelphia could not have questioned Defendants on why they signed factual confessions before such confessions were executed, and (as part of the settlement) was barred from asking Defense Counsel and Defendants questions after the settlement. It also ignores the significant difference concerning access to witness testimony between a litigating party and an insurer. Philadelphia could not have conducted discovery before its intervention in the action.

Again, if the deposition discovery related to the settlement in *Water's Edge* had not been permitted, the collusion uncovered in that landmark case would not have been discovered.⁴⁵

5. Objective and Subjective Evidence

Appellants also argue the trial court abused its discretion by allowing deposition discovery because reasonableness is determined solely based upon objective evidence. OB at 44. This contention is another red herring. Under Washington law, a reasonableness

⁴⁵ In *Water's Edge*, 152 Wn. App. at 603, the court found the reasonable value of the \$8.75 million stipulated settlement was really \$400,000.

determination involves factual determinations that must be supported by substantial evidence.⁴⁶ *Villas at Harbour Pointe Owners Ass'n, ex rel.*

*Constr. Associates, Inc. v. Mut. of Enumclaw Ins. Co.*⁴⁷ explains:

In *Glover*, the Washington Supreme Court adopted a number of factors the court should consider in determining the reasonableness of a settlement under RCW 4.22.060. But according to the court, no one factor controls and the trial court retains the discretion to make an objective determination of the reasonableness of the settlement based on the facts and circumstances of each case.

In other words, the court must make an objective determination based upon substantial evidence regarding the Reasonableness Factors. As discussed above, the subjective opinions of attorneys may be a critical aspect of a court's reasonableness determination as in *Water's Edge* where the Court of Appeals recognized and emphasized the great weight that the trial court had given to the defense attorney's analysis.

Moreover, the Court of Appeals' decision in *Steel I* rejected Appellants' arguments that an attorney's subjective opinions are not relevant and that an attorney could not provide objective information:

Petitioners cite to *Dana* for the proposition that a reasonableness evaluation must be made using only objective evidence and, thus, implied waiver cannot apply because attorney-client communications are only ever subjective. We do not agree.

⁴⁶ *Glover v. Tacoma Gen. Hosp.*, 98 Wn.2d 708, 718, 658 P.2d 1230, 1236 (1983), abrogated by *Crown Controls, Inc. v. Smiley*, 110 Wn.2d 695, 756 P.2d 717 (1988).

⁴⁷ 137 Wn. App. 751, 758–59, 154 P.3d 950, 953 (2007), as amended on reconsideration (May 3, 2007) (emphasis added)

* * *

Contrary to petitioners' argument, the *Dana* court did not declare a sweeping rule that attorney-client communications *always* contain only subjective information that could never be placed at issue within the evaluation of a settlement's reasonableness. Rather, the *Dana* court's decision was narrowly tailored based on the facts presented there.⁴⁸

The Court of Appeals' holding that an implied waiver may occur in this context is a rejection of Appellants' argument that subjective beliefs of the attorneys are irrelevant to a reasonableness determination.⁴⁹

Further, the *Water's Edge* decision and common sense dictate that the opinions of defense counsel are extremely relevant, if not critical to the reasonableness of a stipulated settlement. After all, in any settlement involving arm's length negotiations, defendants and their insurers give great weight to defense counsel's evaluation of the plaintiffs' damage claims, the merits of the plaintiffs' liability claims and defenses thereto, relative fault, the risks and expenses of continued litigation, and the extent of the plaintiffs' investigation and preparation of the case. (Factors 1-5 and 8.)

6. Trial Court Must Determine the Reasonable Amount

If Philadelphia was merely required to show the \$25 million stipulated settlement was unreasonable, there would be no need for

⁴⁸ *Steel v. Philadelphia Indem. Ins. Co.*, 195 Wn. App. 811, 826-27, 381 P.3d 111 (2016) (citation omitted.)

⁴⁹ *Id.* at 830 (“We conclude that the better rule is that the doctrine of implied waiver of the attorney-client privilege may apply to settlement reasonableness hearings on a case-by-case determination...”)

deposition discovery—no court would find \$25 million to be a reasonable settlement amount. However, in *Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.*, this division held that if a trial court finds a settlement to be unreasonable, it must determine a reasonable amount.⁵⁰

Under normal circumstances, an intervening insurer faces many challenges when arguing the amount that is reasonable. Here, Philadelphia is further hamstrung because: 1) it cannot even talk to the defense attorney it retained to defend its insureds without leave of the court; 2) the adult plaintiffs and other witnesses were not deposed prior to the settlement; 3) plaintiff counsel now has complete copies of defense counsel's files; and 4) the settlement was not negotiated. CP 1303; CP 475-476; CP 3879; CP 4675; CP 4915; CP 478.

Thus, as the trial court recognized, justice and due process dictate Philadelphia be permitted limited deposition discovery regarding the factors the trial court will consider when it determines reasonableness.

In Washington, a defense attorney's settlement valuation is critical evidence and sometimes *the* critical evidence considered by the trial court in evaluating the reasonableness of a stipulated settlement. As discussed above, information obtained through depositions of defense counsel by the intervening insurance company was critical to the trial court's ruling that

⁵⁰ *Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.*, 137 Wn. App. 810, 820, 156 P.3d 240 (2007).

the reasonable settlement value was \$400,000, not the \$8.75 million stipulated judgment amount in *Water's Edge*.

Moreover, as discussed above, in *Steel I* this division rejected Appellants' argument that an attorney's subjective opinions are not relevant and that an attorney could only provide subjective information about reasonableness. *See § E, supra*.

Finally, Philadelphia should be able to question Defense Counsel about relevant objective facts that are not contained in his files. For example, Appellants have claimed that Defendants had no choice but to settle at whatever amount Appellants demanded because Defense Counsel was ill prepared. Philadelphia should be able to ask Defense Counsel about his preparation for trial.

7. The Trial Court Did Not Abuse Its Discretion

Trial courts tasked with the critical function of uncovering unreasonable or fraudulently inflated settlements through the reasonableness hearing process have purposely been given broad discretion on what procedures to use and how to manage discovery.⁵¹

⁵¹ *See e.g., Brewer v. Fibreboard Corp.*, 127 Wn.2d 512, 529, 901 P.2d 297 (1995) (“The trial judge faced with this task must have discretion to weigh each case individually.”); *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 159, 795 P.2d 1143 (1990) (“we are confident that trial judges will develop their own procedures for handling these cases”); *Pickett v. Stephens-Nelsen, Inc.*, 43 Wn. App. 326, 335, 717 P.2d 277 (1986) (“the procedures for handling evidence at these hearings are within the trial court’s discretion.”).

Here, if Philadelphia is denied the opportunity to conduct the limited deposition discovery permitted by the trial court, Philadelphia will not have a full and fair opportunity to be heard on reasonableness. Justice and due process requires that this Court not disturb the trial court's exercise of discretion in granting such discovery.⁵²

Moreover, if Philadelphia is denied an opportunity to conduct meaningful discovery regarding the reasonableness of the settlement, the trial court's reasonableness determination may not be binding on Philadelphia. In *In re Feature Realty Litig.*,⁵³ the federal district court, applying Washington law, held that where an insurer was not given "a 'full and fair' opportunity to" conduct discovery related to reasonableness, the insurer was not bound by the reasonableness determination in subsequent bad faith litigation.⁵⁴

Here, after considering Philadelphia's arguments and Appellants' objection regarding whether the requested discovery is related to the Reasonableness Factors for each deponent, the trial court exercised its discretion and permitted limited disposition discovery based upon the factors the court will consider to determine reasonableness.

⁵² See *Bird v. Best Plumbing Grp., LLC*, 175 Wn.2d 756, 774, 287 P.3d 551, 560 (2012) (due process rights of insurer protected where it was afforded notice, intervened, and participated in a lengthy and highly contested hearing on the issue of the reasonableness.).

⁵³ CV-05-0333-WFN, 2007 WL 2703002 (E.D. Wash. Sept. 13, 2007).

⁵⁴ *Id* at 13.

Finally, Appellants misinterpret the holdings in *Red Oaks Condo Owners' Ass'n v. Sundquist Holdings, Inc.*⁵⁵ and *Howard v. Royal Specialty Underwriting, Inc.*⁵⁶ These decisions did not rule it was error to permit an intervening insurer to conduct discovery, but merely held that the trial courts did not abuse their discretion in making their discovery rulings in the factual circumstances presented in these cases. Indeed, these decisions underscore the importance of preserving a trial court's broad discretion to manage discovery in a reasonableness hearing on a case-by-case basis.⁵⁷

a. No Abuse of Discretion Re Defense Counsel Deposition

It is hardly novel for insurers to depose counsel concerning the reasonableness of a covenant judgment settlement. Intervening insurers were permitted this discovery in *Bird v. Best Plumbing*,⁵⁸ and in *Water's Edge*.⁵⁹

Like the defense attorney in *Water's Edge*, Defense Counsel is a very experienced attorney who defended each of the defendants from the

⁵⁵ 128 Wn. App. 317, 116 P.3d 404 (2005).

⁵⁶ 121 Wn. App. 372, 379-80, 89 P.3d 265, *rev. den.*, 153 Wn.2d 1009 (2005).

⁵⁷ The instant matter involves settlements totaling \$25 million where Defense Counsel had recently reported that 5 of the 6 children's claim had only nuisance value and that the plaintiff counsel had failed to develop damages and liability theory for sixth child, who was molested, but at the child's home (not at the daycare center) after the child's mother had invited the daycare worker to live in with the family. CP 3818.

⁵⁸ 175 Wn.2d 756, 774, 287 P.3d 551, 560 (2012)

⁵⁹ 175 Wn.2d 756, 287 P.3d 551 (2012).

inception of litigation. Accordingly, Defense Counsel is in the best position to advise the trial court regarding the reasonableness of the settlements.⁶⁰ Defense Counsel's evaluation of the true settlement value of Appellants' claims—the settlement value of the case had there been arm's length negotiations—is not only relevant, but it is critical to a reasonableness determination.

The trial court's June 22, 2017 order allowing Philadelphia to depose defense counsel “with respect to risk of litigation, preparation for trial, and his opinion regarding liability,” which corresponds to Reasonableness Factors 2, 3 and 5, is clearly within the court's discretion.

b. No Abuse of Discretion Re Plaintiff Depositions

As Philadelphia argued in opposition to Appellant's motion for clarification/reconsideration regarding the Court of Appeals decision that Philadelphia could depose the Plaintiffs:

Plaintiffs are the only source of facts necessary to evaluate both liability and damages known by Plaintiffs at the time of settlement. For example, the family situations of the children, the parents' observations regarding their children, information regarding how the alleged victim compares to his or her siblings at about the same age, as well as an evaluation of the parents' credibility are critical to Philadelphia's reasonableness expert's evaluation of liability and damages.⁶¹

⁶⁰ Again, Defendants waived privilege as part of the settlement. CP 7134 - 7135.

⁶¹ CP 7492.

The Court of Appeals appeared to agree with Philadelphia since the only modification the court made to its prior order was to give the trial court discretion, which is consistent with Washington law in this regard.

As discussed in Philadelphia's Brief Re Deposition Discovery, for five of the six children, the merits of Plaintiffs' liability theory, the merits of the Defense Theory, and the Defendants' relative faults (Factors 2, 3 and 4) will depend upon whether Plaintiffs can show that police and DSHS investigators were wrong, and that it was unreasonable for Defendants to rely upon background checks and police and DSHS investigator reports. CP 7524. For the sixth child, these issues will turn on what the child's mother knew and when she knew it. CP 7524-7525.

The trial court's June 22, 2017 order allowing Philadelphia to depose the adult plaintiffs "with respect to the facts necessary to evaluate both liability and damages known by plaintiffs at the time of settlement," is clearly within the trial court's discretion. CP 7849-7851.

c. No Abuse of Discretion Re Defendant Depositions

The trial court did not abuse its discretion when it ordered that Philadelphia could depose the Defendants regarding the veracity of the factual confessions which contradicted their prior testimony and the evidence. To date, no evidence has been presented to demonstrate any

factual basis for Defendants' sudden admission that abuse occurred at the learning center/daycare (the evidence indicated that 5 of the 6 children were never abused and that the 6 child was abused, but not at the daycare) or that Defendants breached their standard of care. Philadelphia must be able to explore the basis of the factual confessions. If the factual confessions are not supported by any evidence, this would be powerful evidence that the settlements are the product of bad faith, collusion or fraud (Factor 7).

Nor did the trial court abuse its discretion by allowing Philadelphia to question the Defendants regarding their ability to pay (Factor 6). Appellants assert that a correspondence by defendant Olson indicating his understanding that Defendants would be required to pay the difference between the policy limits and the final judgment provides sufficient evidence regarding Defendants' ability to pay a judgment. OB at 75. However, this correspondence merely indicates Mr. Olson's understanding of his potential liability; it contains no information about his or the other Defendants' ability to pay a judgment. OB at 57, CP 7672.

The trial court's June 22, 2017 order allowing Philadelphia to depose the Defendants "with respect to defendants' ability to pay or contribute to settlement or the judgment, and in their opinion, the veracity of the factual confessions," is clearly within his discretion. CP 7849-7851.

d. No Abuse of Discretion Re SGAL Depositions

Although it is unusual for SGALs to be deposed, the trial court limited Philadelphia to questions regarding the circumstances regarding the SGALs' retention, what information was provided to the SGALs, and whether they were influenced by any counsel regarding their reports. VRP 40:19-41:3. Further, this discovery was permitted because Philadelphia demonstrated to the trial court that the SGALs' testimony may provide evidence as to whether the stipulated settlements are the product of bad faith, collusion or fraud. (Reasonableness Factor 7).

If plaintiff counsel provided the SGALs inaccurate information in order to improperly influence the recommendations in their reports, this would be evidence of bad faith, collusion, or fraud (Factor 7) since it appears plaintiff counsel believed (at the time) that the SGAL reports would be used to support reasonableness. CP 5426. Importantly, the trial court has not ruled on the admissibility of the SGAL reports or of their testimony regarding reasonableness. CP 5485 - 5486.

The trial court's June 22, 2017 order allowing Philadelphia to depose the SGALs is clearly within his discretion.

B. The Trial Court Correctly Dismissed the Adult Plaintiffs

1. Covenant Judgment Agreements

A stipulated judgment with a covenant not to execute is a partial pre-trial settlement device that differs from a complete release.⁶² Usually, when an insured enters a covenant judgment agreement, the insured agrees to a judgment and assigns claims against its insurance carrier to the claimant in exchange for a covenant not to execute on the insured's other assets. "This type of settlement agreement, often referred to as a 'covenant judgment,' does not release a tortfeasor from liability; it is simply an agreement to seek recovery only from a specific asset—the proceeds of the insurance policy and the rights owed by the insurer to the insured."⁶³ The Court of Appeals in *MOE v. Day* explained the workings of a traditional covenant judgment:

In a more traditional covenant judgment, the tort victim takes an agreed judgment against the insured in exchange for a covenant by the tort victim not to execute on any of the insured's assets except the insured's claims against its own insurer, and the insured assigns those claims to the tort victim. **Such covenant judgments do not release the insured from liability; rather, they limit recovery to "a**

⁶² See *Barton v. State, Dep't of Transp.*, 178 Wn.2d 193, 206-07, 308 P.3d 597 (2013) (distinguishing between partial, pretrial settlement devices that do not completely release a defendant, such as covenants not to sue, covenants not to execute judgment, and loan receipt agreements from full releases). A full release does release the insured from liability. *Barton*, 178 Wn.2d at 206-07.

⁶³ *Bird*, 175 Wn.2d at 765, internal quotation marks omitted.

specific asset—the proceeds of the insurance policy and the rights owed by the insurer to the insured.”⁶⁴

If the insurer has engaged in bad faith while defending under a reservation of rights, then the claimant pursuing an assigned bad faith claim against the insurer may be entitled to a rebuttable presumption of harm and coverage by estoppel.⁶⁵ The only purpose of covenant judgment agreements is to attempt to establish damages that an insurer will be required to pay in an assigned bad faith action against the settling defendants’ insurer.⁶⁶

2. These Release Agreements Differ from Covenant Judgment Agreements

The Release Agreements at issue in this appeal are highly unusual in the context of a stipulated judgement with a covenant not to execute, because they fully and unconditionally release the Defendants from liability for the claims brought against them. *MOE v. Day* held that a stipulated judgment agreement that fully insulates the insured from liability for the agreed judgment is not effective for the purpose of establishing damages for a later bad faith action against the settling defendants’ insurer.⁶⁷ There, Division I held that the trial court erred

⁶⁴ *MOE v. Day*, 197 Wn. App. at 756-57 (emphasis added).

⁶⁵ See *Besel*, 146 Wn.2d at 737.

⁶⁶ See *Werlinger v. Warner*, 126 Wn. App. 342, 109 P.3d 22 (2005)

⁶⁷ *MOE v. Day*, 197 Wn. App. at 757.

when it entered a stipulated settlement amount, which (with interest) totaled over \$10 million.

The *MOE v. Day* Court expressly recognized that a covenant judgment agreement that includes a complete release is atypical – so much so that it has a different effect than covenant judgment agreements. The *Moe v. Day* Court stated that the most important factor in its analysis was Day’s complete release.⁶⁸ The court compared the case to *Werlinger v. Clarendon National Insurance Co.*,⁶⁹ where the Washington Court of Appeals held that an insured could not establish harm when the insured and his spouse were shielded from personal liability by their bankruptcy status. Relying on *Werlinger*, the *Moe v. Day* Court held that the trial court erred when it applied the stipulated settlement amount as a measure of damages for bad faith, since the insured was legally insulated from any exposure on the agreed judgments, independent of any claims against her insurance carrier and because any presumption of harm was rebutted by the release.⁷⁰

Although the language and specific terms of covenant judgment settlements vary from case to case, they never include an unconditional release of all claims against the defendants. Appellants admit that

⁶⁸ *Id* at 765.

⁶⁹ 129 Wn. App. 804 (2005).

⁷⁰ *MOE v Day*, 197 Wn. App. at 766.

traditional covenant judgment agreements do not “release a settling defendant from liability for the *stipulated judgment itself*,” but instead limit recovery on that judgment to the proceeds of the insurance policy and the rights owed by the insurer to the insured. OB at 27. Ignoring the terms of the Release Agreements, Appellants assert that these Release Agreements are traditional covenant judgment agreements. Philadelphia has been unable to locate a single Washington appellate or federal district court decision that would support the treatment of these agreements as effective covenant judgment agreements. CP 7539 - 7550. William Ashbaugh, personal counsel for Defendant Olson, testified at his deposition that he has *never* seen a release in the context of a covenant judgment agreement. CP 7555 - 7556. Moreover, *MOE v. Day* held that where the insured is fully insulated from liability under the terms of the covenant judgment settlement agreement, as here, any presumption of harm is rebutted. Consequently, an insured’s assignee must prove bad faith damages the old-fashioned way instead of relying upon the stipulated settlement amount as a measure of damages against the insurer.⁷¹

Appellants also attempt, but fail, to distinguish the Release Agreements from the settlement agreement in *MOE v. Day*. Appellants rely on three cases which were decided prior to *Besel v. Viking Ins. Co. of*

⁷¹ *MOE v. Day*, 197 Wn. App. at 766.

Wisconsin,⁷² where the Washington Supreme Court first held that the amount of a covenant judgment is the presumptive measure of an insured's harm caused by an insurer's tortious bad faith if the covenant judgment is found reasonable. The cases cited by Appellants do not involve a covenant judgment, a reasonableness hearing, or address the effect of a full release of claims on the use of a covenant judgment as a presumptive measure of damages for an insurance bad faith claim. Thus, these cases are also not on point topically. *Steinmetz v. Hall-Conway-Jackson, Inc.*,⁷³ involved the assignment of a claim against an insurance agent for failure to procure insurance. *Kagele v. Aetna Life & Cas. Co.*,⁷⁴ involved a settlement agreement which did not contain a release of liability like the one found in Appellants' Release Agreements.⁷⁵ *Steil v. Florida Physicians' Ins. Reciprocal*,⁷⁶ was decided under Florida law as it existed in 1984, not current Washington law. The cases Appellants rely upon stand for the unremarkable proposition that an insured may assign a claim she possesses against an insurer or an insurance agent, and they simply do not apply to the matter at hand.

⁷² 146 Wn.2d 730, 738, 49 P.3d 887, 891 (2002).

⁷³ 49 Wn. App. 223, 741 P.2d 1054 (1987).

⁷⁴ 40 Wn. App. 194, 698 P.2d 90 (1985).

⁷⁵ *Id.* at 197.

⁷⁶ 448 So. 2d 589, 592 (Fla. Dist. Ct. App. 1984).

The Release Agreements provide a complete release of liability, regardless of the outcome of a later bad faith claim, or any other claim. CP 478. Appellants admit that the agreements release the Defendants from liability. OB at 14, 30. Accordingly, the Defendants are not liable for the adult plaintiffs' claims, and any judgment entered would be moot and subject to immediate vacatur.⁷⁷ Appellants' focus on the fact that the agreements do not release Philadelphia, who was not a party to the agreement or the lawsuit, is misplaced. OB at 32. As Defendants' insurer, Philadelphia's duty to pay a judgment is predicated on the insured's actual legal liability for that judgment.⁷⁸

MOE v. Day confirms Philadelphia's position –the stipulated settlement amounts cannot serve as the *presumptive measure of damages* for the assigned bad faith claims. Thus, a reasonableness hearing as to the adult plaintiffs' claims would serve no purpose and the trial court lacks jurisdiction.⁷⁹ If and when the adult plaintiffs assert assigned bad faith

⁷⁷ *U.S. Bancorp Mortgage Co. v. Bonner Mall P'ship*, 513 U.S. 18, 25 (1994).

⁷⁸ *Nat'l Sur. Corp. v. Immunex Corp.*, 162 Wn. App. 762, 774, 256 P.3d 439, 445 (2011), *aff'd*, 176 Wn.2d 872, 297 P.3d 688 (2013), citing *Hayden v. Mut. of Enumclaw Ins. Co.*, 141 Wash.2d 55, 64, 1 P.3d 1167 (2000) (“In contrast, the duty to indemnify ”hinges on the insured’s actual liability to the claimant and actual coverage under the policy.”)

⁷⁹ See *Villas at Harbour Pointe*, 137 Wn. App. at 760-761; *MOE v Day*, 197 Wn. App. at 766.

claims against Philadelphia, under whatever theory they ultimately articulate, they will be required to prove damages in the normal way.⁸⁰

3. The Full Release of the Defendants Cannot Be Striken or Modified

Appellants argue, wholly without citation to authority, that application of *MOE v. Day* to the Release Agreements requires that the trial court engage in modification, rescission, or re-writing of the Release Agreements. OB at 32-34. This argument is not supported by the law or the language of the Release Agreements.

Settlement agreements are contracts, and are considered under the common law of contracts.⁸¹ When contract language is clear and unambiguous, the court must enforce it as written.⁸² Ambiguities in a contract are construed against the drafter.⁸³ There is no dispute that the Release Agreements were drafted solely by the Appellants and were not negotiated with the Defendants, other than a single request by personal counsel to include OELC in the covenant not to execute the judgement on other assets. CP 478. Accordingly, any ambiguities in the Release

⁸⁰ See *Water's Edge Homeowners Ass'n v. Water's Edge Associates*, 152 Wn. App. 572, 594–96, 216 P.3d 1110, 1122–23 (2009), (“[w]ithout this presumptive value, the [claimant] must start from scratch to establish damages in the bad faith claim.”)

⁸¹ See *Evans & Son, Inc. v. City of Yakima*, 136 Wn. App. 471, 477, 149 P.3d 691 (2006).

⁸² *Washington Public Util. Dists.' Utils. System v. Public Utility Dist. No. 1*, 112 Wn.2d 1, 10, 771 P.2d 701 (1989).

⁸³ *Emter v. Columbia Health Servs.*, 63 Wn. App. 378, 384, 819 P.2d 390 (1991) (drafter cannot take advantage of ambiguities it could have prevented with greater diligence).

Agreements must be construed against the Appellants, and in the manner most favorable to the Defendants.

Paragraph 5 of the Release Agreements is clear and unambiguous, and provides that “Plaintiff forever releases and discharges Defendants from any and all of Plaintiff’s claims...,” effective on execution of the Release Agreements. CP 746 - 1010. “The plain meaning of ‘release’ is the surrender of a claim, which may be given for less than full consideration, or even gratuitously.”⁸⁴ Under the plain language of the Release Agreements, Defendants have obtained a complete release of the claims brought against them. CP 746 - 1010. Even if the language of the Release Agreements is ambiguous, which it is not, the ambiguity would be construed in favor of Defendants; Defendants obtained a complete release upon execution of the agreements. CP 746 - 1010. There is no basis whatsoever to require the court to re-write the Release Agreements to provide additional benefits to their drafter.

Furthermore, the severability clause contained in Paragraph 11 of the Release Agreements, relied upon by Appellants, does not allow for the alteration of Paragraph 5. Paragraph 11 states:

If a provision of this agreement is found to be illegal, invalid or unenforceable, the provision shall be fully severable. In Lieu thereof, there shall be added a provision

⁸⁴ *Barton*, 178 Wn.2d at 203 (internal quotations omitted).

as similar in terms to the severed provisions as may be possible and be legal, valid, and enforceable.

CP 791. Paragraph 5, the complete and unconditional release has not been found illegal, invalid, or unenforceable, nor have Appellants so argued.⁸⁵ Accordingly, Paragraph 5 cannot be altered by operation of Paragraph 11. Under the language of Paragraph 11, the unenforceable, provisions must be severed.⁸⁶ Under the terms of the Release Agreement, Paragraph 5 must be enforced, even if other parts of the Release Agreement are found to be illegal, invalid or unenforceable.

Notably, plaintiff counsel is enmeshed in a troubling conflict of interest. Plaintiff counsel now represents *both* Appellants and Defendants, who are clients with interests in direct conflict, in apparent violation of RPC 1.7 (a)(1). CP 2527. There can be no doubt that it would be far better for the Defendants not to have judgments entered against them for the adult plaintiff claims, which amount to \$3.5 million.⁸⁷ CP 7563. Yet

⁸⁵ Appellants' argument that Paragraph 5 is unenforceable because it renders portions of other paragraphs of the agreement unenforceable is wholly unsupported, and only serves to demonstrate that Paragraph 5 itself is fully enforceable.

⁸⁶ Appellants suggest possible modifications of enforceable provisions in an attempt to rescue unenforceable provisions. OB at 33. The only provision possibly requiring severance is paragraph 1, which can be rescued by the inclusion of three words "Defendants' stipulation to." The rehabilitated clause would read:

"1. Amount. Subject to the provisions of paragraphs 2, 3, and 4, Plaintiff agrees to settle the claims against Defendants, for *Defendants' stipulation to* entry of a judgment in the principle amount of [] without costs of attorney's fees, against Olympia Early Learning Center and in favor of Plaintiff."

⁸⁷ Judgments have consequences beyond the payment obligation, such as damage to credit rating.

plaintiff counsel now asks the court to re-write the Release Agreements to the detriment of the Defendants. The demand to re-write the Release Agreements is the equivalent of an assertion of a claim by one client against another client, which would even void informed, written consent to waive the conflict.⁸⁸ RPC 1.7(b). Further, under the terms of the Release Agreements, Defendants are to cooperate and argue in favor of reasonableness *if* there is a reasonableness hearing, and have even turned over all their attorney-client privileged materials to plaintiff counsel. CP 2527. Judge Dixon properly rejected Appellants' request that he rewrite the settlement agreements.

4. Release Agreements Not Binding on Trial Court.

Appellants assert that the trial court is bound to conduct a reasonableness hearing on two bases: 1) because the Release Agreements call for a reasonableness hearing; and 2) because reasonableness of settlement for purposes of setoff provisions of Tort Reform Act contained in RCW 4.22.060 requires a reasonableness hearing. OB at 17. Both arguments fail.

First, the terms of the Release Agreements cannot bind the court. "Courts of law are not bound by parties' stipulations of law."⁸⁹ Accordingly, the parties cannot force the trial court to hold a

⁸⁸ Philadelphia does not know if plaintiff counsel obtained said consent.

⁸⁹ *Rusan's, Inc. v. State*, 78 Wn.2d 601, 606, 478 P.2d 724, 727 (1970).

reasonableness hearing or enter a moot judgment via their Release Agreements.⁹⁰

Second, RCW 4.22.060 is triggered by settlement agreements that resolve claims against some joint tortfeasors in the contributory fault context; not in the insurance context. Rather, Washington courts *adopted* the reasonableness hearing procedure from RCW 4.22.060 to evaluate covenant judgments in the insurance context. Thus, RCW 4.22.060 does not apply here.⁹¹

Third, just as a court would not conduct a reasonableness hearing in the contribution context if the triggering event (settlement by some, but not all joint-tortfeasors) had not occurred, no reasonableness hearing may be conducted here, where there is no possibility that the court's determination will establish the presumptive measure of harm in a separate bad faith action against Philadelphia.

Finally, the trial court lacks jurisdiction to conduct a reasonableness hearing when all insureds have been fully released because there is no justiciable case or controversy that remains.⁹²

⁹⁰ Further, Appellants' argument is not supported by the language of the Release Agreements themselves, as discussed above. Read as a whole, the Release Agreements require that the Defendants stipulate to a judgment and participate in a reasonableness hearing *if one occurs*.

⁹¹ See *Besel*, 146 Wn.2d at 738.

⁹² See *Villas at Harbour Pointe Owners Ass'n ex rel. Constr. Associates, Inc. v. Mut. of Enumclaw Ins. Co.*, 137 Wn. App. 751, 760–61, 154 P.3d 950, 954 (2007), as amended

In sum, the full release of the Defendants renders a reasonableness hearing meaningless.⁹³ The trial court cannot be forced to conduct a meaningless procedure with no legal relevance based on the agreement of private persons.

5. Philadelphia Is Entitled to Relief Under CR 59 or CR 60

Appellants contort themselves to argue, on one hand, that *MOE v. Day* is not a change in the law in hopes of barring relief under CR 60 and, on the other hand, that *MOE v. Day* is an aberration from long-standing case law, in hopes of convincing this Court to ignore *MOE v. Day* when evaluating the Release Agreements. OB at 22; 31. In fact, regardless of whether this Court determines that *MOE v. Day* represents a clarification or change in the law, Philadelphia is entitled to relief.

If *MOE v. Day* is a clarification or change in the law, then CR 60(b)(11) and/or CR 60(c) apply and the trial court properly granted relief under that rule. If *MOE v. Day* is simply an affirmation of existing Washington law, then the trial court's oral ruling in 2012, moving forward with the reasonableness hearing process, was incorrect, and relief should be granted under CR 59. This is because the trial court never entered a written order. Since the time limit to file a motion for reconsideration

on reconsideration (May 3, 2007) (for a court to exercise judicial power, there must be a justiciable case or controversy).

⁹³ *Id.*

under CR 59(b) does not begin to run until an order is entered,⁹⁴ the trial court's verbal ruling may be affirmed as a timely motion for reconsideration. Thus, if relief cannot be granted under CR 60, the trial court's order should be affirmed under CR 59.

Appellants' procedural complaints lack merit. Several valid bases for relief are available under these circumstances, and there are no grounds that precluded the trial court from addressing Philadelphia's motion on the Release Agreements of the adult plaintiffs.

IV. CONCLUSION

This Court should affirm both of the trial court's June 2017 orders. The trial court's discovery order should be affirmed because the discovery ordered was well within the court's discretion. Washington recognizes that covenant judgment settlements create a risk of collusion, because the settling defendant has "no incentive to minimize the amount" of the settlement. The reasonableness hearing in the covenant judgment context exists to protect the settling defendant's insurer from a collusive settlement. The procedures for handling the reasonableness hearing,

⁹⁴ See *Earl v. Geftax*, 43 Wn.2d 529, 262 P.2d 183 (1953) (Trial Court permitted to change final ruling in bench trial at any point prior to entering formal order.); *Barros v. Barros*, 26 Wn. App. 363, 366, 613 P.2d 547, 549 (1980); *Grieco v. Wilson*, 144 Wn. App. 865, 872, 184 P.3d 668, 672 (2008), *aff'd sub nom. In re Custody of E.A.T.W.*, 168 Wn.2d 335, 227 P.3d 1284 (2010) ("An oral decision 'is necessarily subject to further study and consideration, and may be altered, modified, or completely abandoned. It has no final or binding effect, unless formally incorporated into the findings, conclusions, and judgment.'").

including discovery, are within the trial court's discretion. The trial court did not abuse its discretion by allowing Philadelphia to conduct limited discovery tailored to the Reasonableness Factors.

The trial court's dismissal of the adult plaintiff claims should also be affirmed. Like the settlement agreements in *MOE v. Day*, the settlement agreements in this case fully release the Defendants from liability. Thus, the trial court does not have jurisdiction to proceed with a reasonableness hearing as to the adult plaintiffs' claims since the determination will serve no purpose.

The trial court's June 2017 orders should be affirmed.

DATED this 16th day of July, 2018.

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