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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

No. 54413-0-II

SERPANOK CONSTRUCTION, INC.,

Respondent,

v.

POINT RUSTON, LLC; POINT RUSTON PHASE II, LLC; CENTURY
CONDOMINIUMS, LLC; and MICHAEL COHEN,

Appellants.

**AMENDED OPENING BRIEF OF APPELLANTS
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CENTURY CONDOMINIUMS, LLC AND MICHAEL COHEN**

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TABLE OF CONTENTS

I. INTRODUCTION1

II. ASSIGNMENTS OF ERROR.....5

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR5

IV. STATEMENT OF THE CASE.....7

 A. Background Facts Necessary to Understand the Dispute.....7

 1. The Point Ruston Parties are improving Ruston and Tacoma by developing the Point Ruston project.....7

 2. Larry Hutchinson was the Point Ruston project’s Construction Manager and a fiduciary.8

 3. Serpanok was a key concrete subcontractor on the Point Ruston project.....9

 B. The Litigation10

 1. Despite Serpanok’s illegal conduct, Serpanok sued the Point Ruston Parties for breach of contract.10

 2. The Point Ruston Parties proved Serpanok paid Hutchinson bribes and kickbacks.12

 3. Serpanok’s owner destroyed, altered, and manufactured evidence to hide his misconduct, and then lied about all of it, under oath, during the Hearing.14

 4. The Award violated Washington public policy by awarding Serpanok several millions of dollars in profit based on construction subcontracts that arose out of an illegal kickback scheme.....16

 C. The Superior Court confirmed and refused to vacate the Award, despite legal errors on its face.18

V. ARGUMENT19

A. Standard of Review	19
B. Grounds to Vacate an Arbitration Award.....	20
C. The judgment should be reversed and the Award vacated because the Arbitrator exceeded his authority when he applied the wrong legal standards and awarded relief that violates Washington public policy.	21
1. The Award applied the wrong standard to the Point Ruston Parties’ illegality affirmative defense, thus committing a legal error on its face.....	21
i. The Award found Serpanok engaged in illegal conduct but failed to address whether the subcontracts grew immediately out of that conduct.	23
ii. The “grow out of” standard is distinct from—and broader than—proximate cause.....	26
iii. The Award erred by ruling that the Point Ruston Parties had waived their illegality defense.	32
2. The Award’s ruling that the Point Ruston Parties were required—but failed—to prove damages resulting from Serpanok’s kickbacks is a legal error on its face.....	34
3. A public policy tort is a viable Washington claim.	38
4. The Arbitrator exceeded his authority when he issued an Award that violates clearly established Washington public policy.	41
D. The Superior Court should have entered judgment for Cohen.....	45
1. The Superior Court committed reversible error when it confirmed and refused to vacate the Award denying Cohen his contractual attorneys’ fees.....	45

2. The Superior Court committed reversible error by applying sanctions awarded jointly to Cohen as an offset against amounts awarded against another party.47

VI. CONCLUSION.....49

VII. REQUEST FOR ATTORNEYS' FEES49

TABLE OF AUTHORITIES

	Page(s)
Cases	
<i>Agnew v. Lacey Co-Ply</i> , 33 Wn. App. 283, 654 P.2d 712 (1982)	47
<i>Amtruck Factors, Inc. v. Int’l Forest Prod.</i> , 59 Wn. App. 8, 795 P.2d 742 (1990)	<i>passim</i>
<i>Bankston v. Pierce Cty.</i> , 174 Wn. App. 932, 938, 301 P.3d 495 (2013)	21
<i>Becker v. Cmty. Health Sys., Inc.</i> , 184 Wn.2d 252, 359 P.3d 746 (2015)	39
<i>Black v. MTV Networks, Inc.</i> , 576 N.Y.S.2d 846, 848 (1991)	38
<i>Broom v. Morgan Stanley DW Inc.</i> , 169 Wn.2d 231, 237, 236 P.3d 182 (2010)	20, 40
<i>Cacchiotti Props, LLC v. Phillips</i> , 200 Wn. App. 1001 (2017)	37
<i>Coosemans Specialties, Inc. v. Dep’t of Agric.</i> , 482 F.3d 560, 565 (D.C. Cir. 2007)	38
<i>Cornale v. Steward Stamping Corp.</i> , 129 N.Y.S.2d 808, 814 (N.Y. Sup. Ct. 1954)	28
<i>Cornish College of the Arts v. 1000 Virginia Ltd. Partnership</i> , 158 Wn. App. 203, 232, 242, P.3d 1 (2010)	46
<i>Dorsett Carpet Mills v. Whitt Title & Marble Distrib. Co.</i> , 734 S.W.2d 322 (Tenn. 1987)	35
<i>Eagle Point Condo. Owners Ass’n v. Coy</i> , 102 Wn. App. 697, 701, 9 P.3d 898 (2000)	19

<i>Excel Handbag Co. v. Edison Bros. Stores</i> , 630 F.2d 379, 386 (5th Cir. 1980)	40
<i>Fabrique v. Choice Hotels Int’l, Inc.</i> , 144 Wn. App. 675, 183 P.3d 1118 (2008)	27
<i>Federated Servs. Ins. Co. v. Estate of Norberg</i> , 101 Wn. App. 119, 124, 4 P.3d 844 (2000)	20
<i>GMB Enterprises, Inc. v. B-3 Enterprises, Inc.</i> , 39 Wn. App. 678, 695 P.2d 145 (1985)	<i>passim</i>
<i>Golberg v. Sanglier</i> , 96 Wn.2d 874, 879, 639 P.2d 1347 (1982)	21, 24, 25, 27
<i>JSG Trading Corp. v. Dep’t of Agric.</i> , 235 F.3d 608, 615 (D.C. Cir. 2001)	38
<i>Kennewick Educ. Ass’n v. Kennewick Sch. Dist. No. 17</i> , 35 Wn. App. 280, 281–82, 666 P.2d 928 (1983)	20
<i>Kessler v. Jefferson Storage Corp.</i> , 125 F.2d 108, 110 (6th Cir. 1941)	33
<i>Kinzbach Tool Co. v. Corbett-Wallace Corp.</i> , 160 S.W.2d 509 (Tex. 1942)	36
<i>Kitsap Cty. Deputy Sheriff’s Guild v. Kitsap Cty.</i> , 167 Wn.2d 428, 434, 219 P.3d 675 (2009)	19, 42, 45
<i>Maryland Casualty Company v. City of Tacoma</i> , 199 Wash. 72, 94 P.2d 749 (1939)	25
<i>Phillips Chemical Co. v. Morgan</i> , 440 So.2d 1292, 1293–96 (Fl. App. Ct. 1983)	28, 36
<i>Price v. Farmers Ins. Co. of Wash.</i> , 133 Wn.2d 490, 497, 946 P.2d 388 (1997)	48
<i>Reed v. Johnson</i> , 27 Wn. 42, 67 P. 381 (1901)	24, 25, 26, 33

<i>Reed v. Reeves</i> , 160 Wn. 282, 286, 294 P. 995 (1931).....	37
<i>Reichlin v. First Nat. Bank</i> , 184 Wn. 304, 313, 51 P.2d 380 (1935).....	48
<i>Ross v. Kirner</i> , 162 Wn.2d 493, 172 P.3d 701 (2007).....	23
<i>Scribner v. Worldcom, Inc.</i> , 249 F.3d 902, 910 (9th Cir. 2001)	38
<i>Sherwood & Roberts-Yakima, Inc. v. Leach</i> , 67 Wn.2d 630, 639, 409 P.2d 160 (1965).....	33
<i>Sinnar v. Le Roy</i> , 44 Wn.2d 728, 270 P.2d 800 (1954).....	33
<i>State v. Pelkey</i> , 58 Wn. App. 610 (1990)	25
<i>State v. Pelkey</i> , 58 Wn. App. 610, 794 P.2d 1286 (1990).....	24
<i>Tolson v. Allstate Ins. Co.</i> , 108 Wn. App. 495, 498–99, 32 P.3d 289 (2001)	20, 25, 46
<i>Ur-Rahman v. Changchun Dev., Ltd.</i> , 84 Wn. App. 569, 576, 928 P.2d 1149 (1997)	49
<i>Waring v. Lobdell</i> , 63 Wn.2d 532, 533, 387 P.2d 979 (1964).....	21
Statutes	
18 U.S.C. § 1514.....	39
RCW 4.84.330	49
RCW 6.21.080	19
RCW 6.23.0101	19

RCW 7.04A.....	<i>passim</i>
RCW 9A.68.060.....	1, 11, 22, 25
RCW 30.12.080	26, 27
RCW 60.04.181	49
Other Authorities	
<i>Black’s Law Dictionary</i> (11th ed. 2019).....	34
17A C.J.S. Contracts § 281	26
RAP 18.1.....	49

I. INTRODUCTION

Washington's strong public policy prohibits courts from enforcing illegal contracts tainted by bribes and kickbacks. This policy is paramount and supersedes any interest in the finality of arbitration awards. Washington's interest in stamping out corruption is uniformly expressed by courts through the common-law doctrine of illegality. It is also legislatively expressed in statutes like RCW 9A.68.060, which makes commercial bribery a felony, and RCW 7.04A.230(1), which requires courts to vacate arbitration awards procured by corruption, fraud, and other undue means. This appeal asks the Court to decide whether the Superior Court erred as a matter of law when it confirmed an arbitration award that enforced two construction subcontracts tainted by bribes and kickbacks.

Respondent Serpanok Construction, Inc. ("Serpanok") was the primary concrete subcontractor on several key phases of the Point Ruston development project, which sits on the former Asarco smelter EPA Superfund site in Ruston and Tacoma, Washington. Larry Hutchinson was the Construction Manager for the project, who the Arbitrator found owed fiduciary duties to Appellants Point Ruston, LLC, Point Ruston Phase II, LLC, and Century Condominiums, LLC (the "Point Ruston Parties"). Hutchinson was the Point Ruston Parties' highest ranking construction official and was responsible for negotiating the Point Ruston Parties'

subcontracts with Serpanok, supervising and approving Serpanok's work, and negotiating and approving change orders on Serpanok's subcontracts.

The Arbitrator found by a preponderance of the evidence that Serpanok paid bribes and kickbacks to Hutchinson:

[Serpanok paid] approximately \$80,000 [to] Mr. Hutchinson...*for the improper purpose* of attempting to procure favorable change order accommodations, induce Hutchinson to share confidential PR information improperly with Serpanok, and assist Serpanok in submitting change order pricing estimates...or for the purpose of *rewarding* Mr. Hutchinson for his reports that he had engaged or would engage in such conduct.

CP at 1174 (emphasis added).¹

Despite finding that Serpanok engaged in “deplorable” conduct by paying Hutchinson approximately \$80,000 in kickbacks—both before contract formation and during the next two years of construction and contract performance—the Final Arbitration Award (the “Award”) nevertheless enforced the subcontracts growing out of Serpanok's kickback scheme and awarded Serpanok several million dollars. The Superior Court committed reversible error when it confirmed the Award and entered judgment.

First, the Superior Court erred in confirming and refusing to vacate the Award under RCW 7.04A.230(1)(d) because the Arbitrator exceeded

¹ Citations to “CP” refer to the Clerk's Papers prepared by the trial court.

his authority by applying facially incorrect legal standards to several of the Point Ruston Parties' counterclaims and affirmative defenses. Specifically:

- The Award applied the incorrect legal standards to the Point Ruston Parties' illegality defense because it focused on damages instead of analyzing whether the contracts at issue in this case "grew out of" illegal acts or were materially tainted by Serpanok's illegal conduct. The Arbitrator found the contractual relationship between the Point Ruston Parties and Serpanok was tainted by Serpanok's corruption, which should have rendered their contracts void and unenforceable. The Award also incorrectly held the Point Ruston Parties had ratified the contracts, thus waiving their illegality defense, despite Washington authority providing that the defense of illegality cannot be waived.
- The Award incorrectly held the Point Ruston Parties were required to prove actual damages stemming from Serpanok's illegal kickback scheme. Washington case law holds that victims of kickback schemes are not required to prove damages, because kickbacks cause damage as a matter of law.
- The Award committed a legal error in failing to recognize the Point Ruston Parties' counterclaim for public policy tort based on Washington's strong public policy against kickbacks and bribes.

The Arbitrator exceeded his authority, in violation of RCW 7.04A.230(1)(d), in entering an Award that violates Washington public policy. Washington law prohibits enforcement of contracts that grow out of illegal acts—period. Washington law also recognizes that the payment of bribes and kickbacks is illegal, and has recognized that commercial bribery is a criminal offense. The policy animating these conclusions from the Washington Supreme Court and the Washington Legislature is that the

law must discourage misconduct and is not concerned with fairly compensating a wrongdoer. The policy also recognizes the prejudice that results when one party's trusted employee accepts bribes. In short, the Superior Court erred when it confirmed an Arbitration award that, on its face, violates public policy.

Second, the Superior Court erred by confirming the Award and entering a judgment that failed to award any sanctions, fees, or costs to Defendant Michael Cohen. Despite prevailing on the only claim asserted against him, the Award—misapplying relevant law—failed to grant Cohen his attorneys' fees. The Superior Court's failure to vacate this portion of the Award was in error. Further, despite Cohen being jointly awarded \$500,000 in sanctions for Serpanok's spoliation during the arbitration hearing, the Superior Court applied that award as an offset to amounts owed by a different defendant. This allocation was an abuse of the Superior Court's discretion.

The Point Ruston Parties therefore respectfully request this Court reverse the Superior Court's judgment confirming and refusing to vacate the Award and remand this case to the Superior Court with instructions that the case should be returned to the Arbitrator for application of the correct legal standards.

II. ASSIGNMENTS OF ERROR

1. The Superior Court committed reversible error when it confirmed and refused to vacate the Award under RCW 7.04A.230(1)(d) because the Arbitration Award applied the incorrect legal standards to the Point Ruston Parties' counterclaims and affirmative defenses and awarded relief that violates Washington public policy.

2. The Superior Court committed reversible error when it confirmed the Award and entered a judgment that failed to award any sanctions, fees, or costs to Defendant Michael Cohen.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Washington law holds that contracts growing out of illegal conduct are void and unenforceable and that illegality cannot be waived. Here, the Award failed to analyze whether the contracts at issue grew out of Serpanok's illegal conduct and incorrectly found the Point Ruston Parties had waived their illegality defense. Did the Superior Court err by confirming and refusing to vacate the Award's rejection of the illegality defense?

2. Victims of a kickback scheme are not required to prove actual damages because kickbacks cause damage as a matter of Washington law. Here, the Award rejected the Point Ruston Parties' counterclaims for fraudulent inducement and breach of the duty of good faith and fair dealing

for failure to prove damages stemming from Serpanok's illegal kickbacks. Did the Superior Court err by confirming and refusing to vacate the Award's requirement that the Point Ruston Parties prove actual damages resulting from Serpanok's illegal kickbacks?

3. Washington Supreme Court precedent recognizes the availability of public policy torts under certain circumstances and holds that courts are empowered to vacate arbitration awards where they present novel questions of law. Here, the Award declined to grant relief under the Point Ruston Parties' public policy tort counterclaim "until the courts have resolved this issue more clearly." Did the Superior Court err in refusing to vacate the Award and resolve this open legal question?

4. Washington public policy demands that decision makers not lend their aid to the enforcement of illegal acts. Here, based on a misapplication of the relevant legal standards, the Award enforced contracts growing out of illegal acts and awarded the bad actor millions of dollars in profit. Did the Superior Court err in confirming and refusing to vacate an Award that is contrary to clearly established Washington public policy?

5. In Washington, where a contract states the prevailing party is entitled to attorneys' fees, the prevailing party must be awarded those fees. Here, the Award refused to award Cohen his attorneys' fees despite the fact that he prevailed on all claims against him. Did the Superior Court

err by confirming and refusing to vacate the Award's denial of Cohen's request for attorney's fees?

6. A Superior Court abuses its discretion when its application of a monetary award as an offset violates equitable principles. Here, the Superior Court applied the \$500,000 in sanctions awarded jointly to all defendants as an offset to an amount owed by only one defendant, denying Cohen any portion of the sanctions award. Did the Superior Court abuse its discretion in applying the full sanctions award as an offset?

IV. STATEMENT OF THE CASE

A. Background Facts Necessary to Understand the Dispute

1. The Point Ruston Parties are improving Ruston and Tacoma by developing the Point Ruston project.

The Point Ruston Parties are separate but related companies devoted to the development of a complex commercial real estate development project in Tacoma and Ruston, Washington commonly known as the Point Ruston project. CP at 1148. Michael Cohen was the Manager of the Point Ruston parties during the relevant period. CP at 1148. The Point Ruston project, the subject of the underlying dispute here, includes condominiums, apartments, retail shops and businesses, restaurants, parking facilities, a cinema, and various other features. CP at 1148–49. The project was built on the site of the former Asarco Copper Smelter, designated a federal

Superfund site by the Environmental Protection Agency, and the surrounding neighborhood. CP at 1149. It involved both sequential and simultaneous construction of multiple buildings and structures over the span of several years. CP at 1149. Construction at the Point Ruston project continues today and is required as part of the EPA's clean-up of the Asarco site.

2. Larry Hutchinson was the Point Ruston project's Construction Manager and a fiduciary.

In late 2013, the Point Ruston Parties hired Larry Hutchinson as the Construction Manager over the entire Point Ruston project. CP at 1472; *cf.* CP at 1171. Hutchinson was the highest ranking construction official on site, and he owed fiduciary duties to the Point Ruston Parties. CP at 1171. Hutchinson was responsible for every facet of construction on the Point Ruston project and answerable only to Cohen.

As Construction Manager, Hutchinson played a key role in negotiating with and monitoring subcontractors. Subcontractors obtain their contracts through a competitive bidding process. Subcontractors are then paid based on the percentage of work completed on the project, subject to the approval of the invoice by the Construction Manager. In other words, subcontractors are not paid until work is completed to the satisfaction of the Construction Manager.

Any change to the scope of work under a subcontract requires a “change order,” which modifies the subcontractor’s scope of work and the subcontract’s fixed price. *See, e.g.*, CP at 1550–51 (contract contains a fixed price with progress billing), CP at 1551–53 (contract defines scope of work), CP 1554 (contract requires an agreement on change orders). The Construction Manager is primarily responsible for negotiating and approving change orders.

As the Construction Manager, Hutchinson’s loyalty to the Point Ruston Parties was required at every step to ensure the project was completed per the terms of the contracts and to the Point Ruston Parties’ satisfaction. A key part of Hutchinson’s job was to watch for and guard against fraud, abuse, or overreach by the subcontractors.

3. Serpanok was a key concrete subcontractor on the Point Ruston project.

Shortly after Hutchinson became Construction Manager, Serpanok started bidding on major Point Ruston construction projects, including the projects known as the Building 11/9 Public Parking Garage (the “Garage”) and Building 1A. CP at 1149. Building 1A houses the project’s anchor tenant, the Cinemark movie theater, as well as other commercial space, residential condominiums and apartment units. CP at 1149, 1562, 1662. The Garage provides public parking for the cinema, retail space, and

common areas of the project. In 2014, Serpanok and Point Ruston Phase II, LLC, entered into two subcontracts requiring Serpanok to complete the concrete work on Building 1A and the Garage. CP at 1149.

As Construction Manager, Hutchinson was personally involved in negotiating the two subcontracts (and his signature appears on the Garage subcontract, CP at 1562). Hutchinson also personally negotiated and executed the majority of Serpanok's change orders, was responsible for ensuring Serpanok performed its contractual obligations, and was personally responsible for reviewing Serpanok's work and signing off on progress billing. *See* CP at 1233–45. Despite Hutchinson owing a duty of complete loyalty to the Point Ruston Parties, Serpanok secretly paid Hutchinson approximately \$80,000 in bribes and kickbacks throughout the entire period Hutchinson was employed until his termination in November 2015. CP at 1158, 1171.

B. The Litigation

1. Despite Serpanok's illegal conduct, Serpanok sued the Point Ruston Parties for breach of contract.

On November 29, 2016, Serpanok filed a Complaint in Pierce County Superior Court against the Point Ruston Parties, followed by an Amended Complaint on December 15, 2016. CP at 2–51. The Amended Complaint asserted claims for breach of two construction subcontracts (the

Building 1A and Garage subcontracts), foreclosure on two mechanics' liens, breach of a promissory note, and conversion of construction equipment. CP at 34–51. In total, Serpanok sought \$5,934,937 in damages for breach of the subcontracts and \$151,781 for conversion. CP at 51. On February 21, 2017, the Point Ruston Parties moved to enforce the subcontracts' mandatory arbitration clauses. CP at 52–63. The Superior Court granted that motion, concluding, among other findings, that Serpanok's only claim against Cohen (for conversion) was subject to the same arbitration provision in the subcontracts as the contractual breach and foreclosure claims because the conversion claim was "tied directly to the performance of the contract in that it concerns equipment used in the performance of the contract." CP at 220.

On May 2, 2017, Serpanok initiated arbitration with the American Arbitration Association. CP at 1148. Serpanok amended its allegations and damages, and when determined it could not support the higher value on any plausible theory, it ultimately sought an award of \$4,446,976 on its contract claims and \$255,866.56 on its conversion claim. CP at 1149. The Point Ruston Parties denied all liability and asserted counterclaims against Serpanok, including counterclaims for fraudulent inducement, aiding and abetting Larry Hutchinson's breach of fiduciary duties, and a public policy tort claim asserting a private right of action under RCW 9A.68.060. CP at

1149–50. The Point Ruston Parties also asserted affirmative defenses against Serpanok’s claims, including an illegality defense. CP at 1178. In concluding all claims and counterclaims were subject to arbitration, the Arbitrator expressly found that *every claim at issue* in the proceeding were disputes that “concerned” and were “inextricably intertwined with” the two subcontracts at issue. CP at 1154.

2. The Point Ruston Parties proved Serpanok paid Hutchinson bribes and kickbacks.

On April 5, 2019, the parties completed a three-week arbitration hearing. CP at 1151. During those three weeks, the Point Ruston Parties presented indisputable and overwhelming evidence of Serpanok and Hutchinson’s corrupt scheme against the Point Ruston Parties, which led to the Arbitrator’s conclusion that Hutchinson had been secretly working as Serpanok’s agent throughout his entire tenure as the Point Ruston Construction Manager, that Serpanok had paid Hutchinson at least \$80,000 in kickbacks during that time, and that Serpanok and Hutchinson had engaged in “deplorable” conduct that the Arbitrator did “not condone.” CP at 1160, 1171–72.

The Arbitrator found, based on Serpanok’s own expert testimony, that Hutchinson’s duty as Construction Manager of the project “was to ‘ride for the Point Ruston brand’ completely and loyally during his tour of duty

as the PR Construction Manager.” CP at 1172. He failed to do so. Instead, with Serpanok’s “substantial encouragement and assistance,” CP at 1171, and as shown by evidence presented at the hearing, Hutchinson:

- Purported to negotiate subcontracts on behalf of the Point Ruston Parties, but secretly prepared Serpanok’s bids for those subcontracts (having actual knowledge of the competing bids and the internal budgets), and then instructed Kunitsa to email the bids to the Point Ruston Parties to hide this fact, all while using a Serpanok email signature from his private email account. CP at 1517–33;
- Leaked internal cost estimates and competing bids to Serpanok, including a bid that one of its competitors had submitted for the Garage, then schemed with Kunitsa about how closely they could undercut the competitor’s bid to win the Garage subcontract, using the leaked information. CP at 1509–14;
- Took over the negotiation of the Garage subcontract so he could scheme with Kunitsa to increase Serpanok’s profit when Serpanok’s scope of work on the Garage was drastically reduced, but its contract price was not. CP at 1625, 1622;
- Purported to negotiate, on behalf of the Point Ruston Parties, disputed and lucrative change orders that benefited Serpanok. CP at 1302, 1569–73, 1602–04, 1622; and
- Engaged in a course of conduct during his entire tenure that shows a pattern of favors followed by secret payments to a shell company owned by Hutchinson’s wife, which was created to hide the nature of the payments. *See* CP at 1255–1273.

The Arbitrator found that, throughout Hutchinson’s entire employment at Point Ruston, Serpanok was making “improper payments” to Hutchinson that totaled more than \$80,000. CP at 1171. Although Serpanok falsely claimed these payments compensated Hutchinson for

work unrelated to the Point Ruston project, the Arbitrator found that Serpanok's "contentions that these were legitimate payments made to compensate Hutchinson for 'moonlighting' work for Serpanok on unrelated projects were not established or persuasive." CP at 1171.

3. Serpanok's owner destroyed, altered, and manufactured evidence to hide his misconduct, and then lied about all of it, under oath, during the Hearing.

Serpanok's misconduct did not end when the Point Ruston Parties fired Hutchinson, or even when the parties commenced arbitration. The Point Ruston Parties discovered, in the middle of the three-week hearing, that Kunitsa lied under oath about the existence of damning bookkeeping records (organized by a construction accounting program known as Master Builder) confirming that his improper payments to Hutchinson were related to the Point Ruston project. *See* CP at 1171, 1174. Throughout the discovery period, Kunitsa hid these records of the improper payments to Hutchinson (which were repeatedly requested in discovery by the Point Ruston Parties) by lying about the contents of Master Builder and denying the existence of records regarding payments to Hutchinson. CP at 1174, 2456-60.² Although Kunitsa was ordered to produce Master Builder records less than six months before the hearing, midway through the

² The Arbitrator adopted in his Award the Point Ruston Parties' description of Serpanok's misconduct in their post-hearing brief. CP at 1174.

hearing, it came to light that, before producing the records, Kunitsa had manually deleted every single entry showing a Serpanok payment to Hutchinson that was coded as relating to the Building 1A and Garage subcontracts. CP at 2459.

Under cross-examination, Serpanok's bookkeeper admitted that she could not explain a number of discrepancies on the face of the documents. CP at 1174. The Arbitrator then ordered a forensic examination of Serpanok's computer system and Master Builder records, which revealed Kunitsa's misconduct. CP at 2458. Summarizing Serpanok's misconduct, the Award found:

Mr. Kunitsa repeatedly misinformed counsel and this Tribunal...concerning the nature of the information captured and available on Serpanok's Master Builder bookkeeping records. Then, after an effective cross-examination of Serpanok's bookkeeper...revealed the true contents of those records, Mr. Kunitsa improperly and surreptitiously attempted to alter those records...to conceal information he...felt would be damaging to Serpanok's case.

CP at 1174 (emphasis added). The Arbitrator sanctioned Serpanok \$500,000 for these lies and flagrant discovery violations that were designed to hide the connection between the illicit payments and the subcontracts. CP at 1181.

4. The Award violated Washington public policy by awarding Serpanok several millions of dollars in profit based on construction subcontracts that arose out of an illegal kickback scheme.

On June 19, 2019, the Arbitrator issued an interim award that awarded Serpanok several million dollars in contract damages based on the Building 1A and Garage subcontracts. CP at 1152. On July 1, 2019, the Point Ruston Parties moved for reconsideration, explaining that the interim award had applied the wrong legal standards. CP at 1152. On October 18, 2019, the Arbitrator denied reconsideration and issued the final Award. CP at 1147. The Award found:

The evidence presented established, by a preponderance of the evidence, that approximately \$80,000 was paid to Mr. Hutchinson [a person in authority] by Serpanok during the relevant two year period *for the improper purpose* of attempting to procure favorable change order accommodations, induce Hutchinson to share confidential PR information improperly with Serpanok, and assist Serpanok in submitting change order pricing estimates...or for the purpose *of rewarding* Mr. Hutchinson for his reports that he had engaged or would engage in such conduct.

CP at 1171 (emphasis added). The Award found this illegal conduct supported a holding that Serpanok aided and abetted the breach of Hutchinson's fiduciary duties and awarded the Point Ruston Parties as damages not only the amount of the improper payments, but also every dollar of salary Hutchison earned throughout his two-year tenure as the Point Ruston Parties' Construction Manager. CP at 1171. The Award thus

necessarily found that Hutchison was secretly working on Serpanok's behalf every day he was supposed to be negotiating and signing Serpanok's subcontracts and change orders on behalf of the Point Ruston parties and supervising Serpanok's performance under those same subcontracts. CP at 1154 (every claim and counterclaim inextricably intertwined with the subcontracts). The Award specifically found: "Mr. Kunitsa and Mr. Hutchinson engaged in a course of conduct that I found deplorable and do not condone." CP at 1160.

Despite these findings of illegal conduct, the Award enforced the tainted subcontracts. CP at 1156. In so doing, the Award rejected the Point Ruston Parties' illegality affirmative defense and their counterclaims for fraudulent inducement, breach of the duty of good faith and fair dealing, and public policy tort. CP at 1157-60, 1165-66, 1173-74, 1178. The Award additionally rejected Serpanok's claim for conversion, the only claim against Michael Cohen. CP at 1170-71. In total, the Award held Serpanok, despite paying kickbacks, was entitled to recover a total of \$4,646,062, plus \$1,302,951.29 in attorneys' fees and costs, against Century Condominiums, LLC, Point Ruston Phase II, LLC, and Point Ruston, LLC under the subcontracts. CP at 1189-90. Although Cohen prevailed on the only claim Serpanok asserted against him, the Award denied Cohen's request for attorneys' fees. CP at 1186.

Even before this litigation, and based on Serpanok's own accounting, the Point Ruston Parties had already paid Serpanok \$6.5 million more than its actual costs of construction on the Building 1A and Garage subcontracts. CP at 1252. The amounts awarded to Serpanok in the Award are thus pure profit, all growing out of Serpanok's illegal acts.

C. The Superior Court confirmed and refused to vacate the Award, despite legal errors on its face.

On December 2, 2019, the Point Ruston Parties filed a motion to vacate the Award in Pierce County Superior Court based on the legal errors apparent on the face of the Award. CP at 1110. Serpanok filed its motion to confirm the Award that same day. CP at 1021. The Superior Court, without discussing *any* of the Point Ruston Parties' legal arguments—and without citing the key cases governing the Point Ruston Parties' claims and defenses—denied the Point Ruston Parties' motion to vacate and granted Serpanok's motion to confirm the Award. CP at 2711–14. On March 6, 2020, the Superior Court issued Serpanok a money judgment against Point Ruston, LLC, Point Ruston Phase II, LLC, and Century Condominiums, LLC, along with a foreclosure decree against the Garage owned by Point Ruston Phase II, LLC. CP at 2725–29. In doing so, the Superior Court allocated the \$500,000 sanction for Serpanok's misconduct—which the Arbitrator had jointly awarded to all the Point Ruston Parties, CP at 1188–

90—as an offset to amounts owed by Defendant Century Condominiums, LLC. CP at 1023 ¶ 7, CP at 2727 ¶ 3.

After entering the Judgments, the Superior Court entered an Order allowing Serpanok to foreclose on a \$3,281,125 mechanics’ lien over the Garage and force a sheriff’s sale. CP at 3070–145. On June 19, 2020, the Pierce County Sheriff held a Sale of the Garage, at which Serpanok purchased the Garage for \$3.2 million.³ The Superior Court also issued writs of garnishment allowing Serpanok to seize money the Point Ruston Parties had been using to fund the construction. CP at 3148–65.

V. ARGUMENT

A. Standard of Review

The Superior Court’s decision to confirm or vacate an arbitration award is a pure question of law that this Court reviews de novo. *See Kitsap Cty. Deputy Sheriff’s Guild v. Kitsap Cty.*, 167 Wn.2d 428, 434, 219 P.3d 675 (2009). The Superior Court’s decision to grant an offset is reviewed for abuse of discretion. *See Eagle Point Condo. Owners Ass’n v. Coy*, 102 Wn. App. 697, 701, 9 P.3d 898 (2000).

³ Per RCW 6.21.080 and RCW 6.23.0101, Point Ruston Phase II, LLC maintains redemption rights over the Garage, which expire on June 19, 2021. The Point Ruston Parties therefore respectfully request that this Court issue a ruling before the right of redemption of the Garage expires.

B. Grounds to Vacate an Arbitration Award

The Washington Arbitration Act, RCW 7.04A, *et seq.*, requires Superior Courts to vacate arbitration awards in which the arbitrator exceeds his or her powers or which were procured by corruption, fraud, and other undue means. *See* RCW 7.04A.230(1)(a), (d). An arbitrator exceeds his or her powers, requiring vacation, when the arbitrator’s award contains “facial errors of law,” *Broom v. Morgan Stanley DW Inc.*, 169 Wn.2d 231, 237, 236 P.3d 182 (2010), that are “recognizable from the language of the award.” *Federated Servs. Ins. Co. v. Estate of Norberg*, 101 Wn. App. 119, 124, 4 P.3d 844 (2000). A facial legal error includes awarding remedies that are barred by Washington public policy. *See Kennewick Educ. Ass’n v. Kennewick Sch. Dist. No. 17*, 35 Wn. App. 280, 281–82, 666 P.2d 928 (1983) (vacating an arbitration award of punitive damages because they are barred by public policy). And “internal inconsistency amounts to an error of law on the face of the award.” *Tolson v. Allstate Ins. Co.*, 108 Wn. App. 495, 498–99, 32 P.3d 289 (2001) (vacating an award that could be “read in at least two ways” and “direct[ing] the trial court to seek clarification from the arbitrator”).

Here, the Superior Court erred in confirming and refusing to vacate the Award, which contained a number of facial legal errors and which was

procured by corruption, fraud, and undue means. The Superior Court additionally abused its discretion in its allocation of the sanctions award.

C. The judgment should be reversed and the Award vacated because the Arbitrator exceeded his authority when he applied the wrong legal standards and awarded relief that violates Washington public policy.

1. The Award applied the wrong standard to the Point Ruston Parties' illegality affirmative defense, thus committing a legal error on its face.

In Washington, illegal contracts are void and unenforceable. “Where a plaintiff, to make a case, must rely upon the illegal contract itself, he cannot recover. The law will aid neither party to an illegal agreement, but will leave the parties where it finds them.” *Waring v. Lobdell*, 63 Wn.2d 532, 533, 387 P.2d 979 (1964); *Bankston v. Pierce Cty.*, 174 Wn. App. 932, 938, 301 P.3d 495 (2013) (“A contract that is illegal is void—that is, null from the beginning and unenforceable by either party.”). Notably this “same rule applies if the contract grows immediately out of and is connected with an illegal act.” *Golberg v. Sanglier*, 96 Wn.2d 874, 879, 639 P.2d 1347 (1982); *GMB Enterprises, Inc. v. B-3 Enterprises, Inc.*, 39 Wn. App. 678, 683–84, 695 P.2d 145 (1985) (“Generally, where a contract grows immediately out of, and is connected with, an illegal act, a court of justice will not lend its aid to enforce it.” (internal citations omitted)).

The Arbitrator found facts that proved the affirmative defense of illegality as a matter of law. CP at 1165. The Award found Serpanok and Hutchinson engaged in “deplorable” conduct, finding Serpanok secretly paid Hutchinson \$80,000 in kickbacks to secure more favorable contract terms and treatment and to induce Hutchinson to breach his fiduciary duties. CP at 1160, 1171. The Award expressly found that Serpanok aided and abetted the breach of Hutchinson’s fiduciary duties and that “during the relevant two-year period, the principals did not consent to or ratify those breaches of fiduciary duty.” CP at 1171. Although the Award failed to recognize the result, these findings also amount to a necessary conclusion that Serpanok violated every element of Washington’s criminal bribery statute. *See* RCW 9A.68.060(2)(a) (“A person is guilty of commercial bribery if...he or she offers, confers, or agrees to confer a pecuniary benefit directly or indirectly upon a trusted person under a request, agreement, or understanding that the trusted person will violated a duty of fidelity or trust arising from his or her position as a trusted person.”).

Yet despite these findings, the Award nevertheless rejected the Point Ruston Parties’ illegality defense. CP at 1177–79. Lumping the Point Ruston Parties’ illegality defense with other affirmative defenses, the Award rejected the defense because it found no evidence that the “misconduct proximately caused [] any damage.” CP at 1177 (concluding

illegality defense “inapplicable” without proof of proximate cause). The Award also held that the Point Ruston Parties could not object to the enforcement of the contracts at issue in this case because they ratified the contracts. CP at 1159. Both of these holdings apply the incorrect legal standard to the Point Ruston Parties’ illegality affirmative defense. Applying the correct legal standard, the contracts were void and unenforceable because they grew out of illegal conduct.

i. The Award found Serpanok engaged in illegal conduct but failed to address whether the subcontracts grew immediately out of that conduct.

In rejecting the Point Ruston Parties’ illegality defense for failure to show Serpanok’s conduct proximately caused damages, the Award applied the incorrect legal standard. CP at 1178–79. As an initial matter, and as discussed in more detail in Section V.C.2 below, the Award’s requirement that the Point Ruston Parties prove damages stemming from Serpanok’s payment of illegal payments to Hutchinson was a legal error on the face of the Award. *See Amtruck Factors, Inc. v. Int’l Forest Prod.*, 59 Wn. App. 8, 15–16, 795 P.2d 742 (1990) (holding victims of a kickback scheme are not required to show actual damages stemming from that scheme), *abrogated on other grounds recognized by Ross v. Kirner*, 162 Wn.2d 493, 500, 172 P.3d 701 (2007). Under *Amtruck*, damages are presumed as a matter of law in a kickback case.

Regardless, the Award's application of a proximate cause standard to the Point Ruston Parties' illegality defense was a facial legal error. It is well-established Washington Supreme Court precedent that a contract is deemed illegal where it "grows immediately out of and is connected with an illegal act." *Golberg*, 96 Wn.2d at 879; *Reed v. Johnson*, 27 Wn. 42, 54–55, 67 P. 381 (1901) (agreeing that "where the contract grows immediately out of, and is connected with, an illegal or immoral act, a court of justice will not lend its aid to enforce it"); *GMB*, 39 Wn. App. at 683–84. In evaluating an affirmative defense of illegality, the relevant question is not whether the illegal conduct proximately caused some harm, but whether the contract at issue *grew out of* or was *materially connected with* illegal conduct. The "grow out of" standard is broad and distinct from the narrower proximate cause analysis; in fact, Washington cases discussing the "grow out of" doctrine do not even mention proximate cause. *See Reed*, 27 Wn. at 50; *Golberg*, 96 Wn.2d at 879; *GMB*, 39 Wn. App. at 683–84; *State v. Pelkey*, 58 Wn. App. 610, 615, 794 P.2d 1286 (1990).

Here, the Award found Serpanok engaged in illegal conduct relating specifically to the two subcontracts at issue. The Award stated: "The evidence presented established...that approximately \$80,000 was paid to Mr. Hutchinson by Serpanok during the relevant two year period for [an] improper purpose." CP at 1171. This conduct led to a finding that Serpanok

aided and abetted Hutchinson's breach of his fiduciary duties, which is illegal. *See Maryland Casualty Company v. City of Tacoma*, 199 Wash. 72, 82–83, 94 P.2d 749 (1939) (contracts encouraging a breach of fiduciary duty are illegal). Serpanok's conduct also amounts to a violation of Washington's commercial bribery statute and therefore was illegal. *See* RCW 9A.68.060; *Pelkey*, 58 Wn. App. at 615 (“[T]he transaction presented here resembles an illegal contract because it grows out of and is connected with an illegal act, *i.e.*, bribery.”).

Washington law does not examine whether an illegal act is the proximate cause of damages to determine whether a contract is illegal, only whether the contract grew immediately out of the illegal act. *See Golberg*, 96 Wn.2d at 879. The Award (and the Superior Court) did not apply—or even acknowledge—the “grow out of” standard, which is facial error. Indeed, the Award's finding that Serpanok engaged in deplorable, illegal conduct is internally inconsistent with its rejection of the Point Ruston Parties' illegality defense, and emphasizes the Award's failure to apply the correct legal standard. *See Reed*, 27 Wn. at 50 (holding the “least taint of illegality or want of equity will preclude a decree” enforcing illegal contracts); *see also Tolson*, 108 Wn. App. 498–99 (“[I]nternal inconsistency amounts to an error of law on the face of the award.”). This failure to apply the correct legal standard to the Point Ruston Parties' illegality defense is a

facial legal error requiring vacation of the Arbitration Award under RCW 7.04A.230(1)(d).

ii. The “grow out of” standard is distinct from—and broader than—proximate cause.

It is well established that contracts growing out of illegal conduct are illegal and unenforceable. For example, the Washington Supreme Court has held, “[i]t is a general rule that contracts which tend to place the officers of a corporation under an inducement to disregard their duties to the corporation...are illegal and void.” *Reed*, 27 Wn. at 50; *see also* 17A C.J.S. Contracts § 281 (explaining contracts contributing to “a fraud or breach of trust or breach of duty on the part of one who stands in a fiduciary or confidential relation, are illegal and void”).

The *GMB* case, cited above, involved the application of a banking fraud statute, RCW 30.12.080(3), that prohibited bank officers and employees from receiving a benefit from a loan transaction. 39 Wn. App. at 681. There, the court analyzed whether a lease agreement was void where a bank employee—who had overseen a farm loan on the same property three months prior—received a portion of the proceeds of the lease. *Id.* at 681–82. Despite the fact that the lease was signed three months after the loan transaction, the Court analyzed the relationship between the two agreements and concluded the lease agreement was connected to the earlier loan

contract such that it violated RCW 30.12.080(3), making the lease void and unenforceable. *Id.* at 683–84. In addition to recognizing the established Washington law that courts will not enforce contracts that “grow[] immediately out of” illegal acts, the court explained the policy concerns driving its decision:

The fundamental concern that should guide a court in making its decision is whether “the public good [will be] enhanced.” The key to a determination of this nature is whether our decision will be more likely to *prevent such illegal transactions in the future.*

Id. at 683, 688 (quoting *Golberg*, 96 Wn.2d at 883) (emphasis added). At no point did the Court analyze, or even discuss, the concept of proximate cause, or whether any party to the illegal contract suffered damages.

Applying the principles of *GMB*—which involved facts far less egregious than the facts of this case—it is clear that the analysis of whether a contract grew immediately out of illegal conduct is broader than a typical proximate cause analysis, and it is driven by public policy considerations. The “proximate cause of an injury is defined as a cause that, *in a direct sequence*, unbroken by any new, independent cause, produces the injury complained of and *without which the injury would not have occurred.*” *Fabrique v. Choice Hotels Int’l, Inc.*, 144 Wn. App. 675, 683, 183 P.3d 1118 (2008) (emphasis added). But *GMB* applied a broader, more fluid test, analyzing the relationship between two separate transactions and

emphasizing that the key question is whether the court’s decision “will be more likely to prevent [] illegal transactions in the future.” 39 Wn. App. at 688; *see also Amtruck*, 59 Wn. App. at 21 n.3 (“Courts will not enforce a contract if it is illegal or grows immediately out of and is connected with an illegal act....[A] contract which is not itself illegal may be enforced if it is...sufficiently remote from the illegal transaction.”).

From a policy perspective it makes sense to conclude contracts obtained as the result of kickbacks or breaches of fiduciary duties grow immediately from illegal conduct and are thus void and unenforceable to discourage corruption. Indeed, other courts have refused to enforce contracts stemming from kickbacks and breaches of fiduciary duties. *See, e.g., Phillips Chemical Co. v. Morgan*, 440 So.2d 1292, 1293–96 (Fl. App. Ct. 1983) (finding a “flagrant case of commercial bribery involving kickbacks” that led to a purchase agreement “constitute[d] a complete defense” to plaintiff’s attempt to enforce the purchase agreement); *Cornale v. Steward Stamping Corp*, 129 N.Y.S.2d 808, 814 (N.Y. Sup. Ct. 1954) (plaintiff who “had knowledge of [an employee’s] breach of duty and wrongfully participated therein” could not “recover for goods sold and delivered”). A different rule would not “prevent such illegal transactions in the future,” *GMB*, 39 Wn. App. at 688, but could incentivize future kickback schemes by permitting the perpetrator—like Serpanok—to recover millions

of dollars in damages under contracts it obtained illegally. Encouraging misconduct is inconsistent with Washington law or policy.

That the subcontracts grew out of Serpanok's illegal conduct is clear: Serpanok bribed the Construction Manager who oversaw both contract formation and contract performance to induce him to breach his duties to the Point Ruston Parties. There was no other purpose in bribing him, other to gain improper influence over the bidding process and Hutchinson's supervision of Serpanok's contract performance and the execution of contract change orders. The Arbitrator based his breach-of-fiduciary-duty finding on mountains of undisputed evidence that the breaches were related to these specific contracts. For example, Hutchinson—while purportedly working on behalf of the Point Ruston Parties as their Construction Manager—(a) leaked to Serpanok a competitor's bid for the Garage project on March 14, 2014 using a private email account so that Serpanok could underbid it (CP at 1507–12), (b) *drafted* Serpanok's bid for the Garage project on March 17, 2014, which Hutchinson emailed to Kunitsa using a "Serpanok" signature block (CP 1522–1528), and (c) schemed with Kunitsa on how to avoid suspicions with the tainted bid, including how it was to be submitted by Kunitsa to Hutchinson's subordinate, Yuchun Santory, on March 17, 2014 (CP at 1512–33). Serpanok paid Hutchinson \$3,500 on March 21, 2014 (CP at

1541) and Hutchinson formally awarded Serpanok the Garage project on March 24, 2014 (CP at 1545).

Similarly, the Point Ruston Parties presented unequivocal evidence that immediately before the Garage project's written contract was executed on December 19, 2014, Hutchinson privately communicated with Kunitsa on December 17, 2014 about the amount the contract's price should be reduced to account for a reduction in the size of the Garage (*i.e.*, a larger credit against the contract price would mean less money for Serpanok). CP 1618–1622. After Kunitsa initially proposed a credit of only \$206,990, Hutchinson wrote that he thought the credit was “very light” (CP at 1618) and that it needed to be “close to” \$335,000 (CP at 1625). But after some back-and-forth with Kunitsa, he agreed to give Serpanok only a \$230,000 credit with the promise to pay Serpanok another \$20,000 in future change orders, stating “[t]his I can do without explanation.” CP at 1622. Kunitsa paid Hutchinson \$7,000 on December 19, 2014—*i.e.*, the day Kunitsa executed the contract. CP at 1630. Although Serpanok paid Hutchinson kickbacks close in time to these two incidents,⁴ the Award did not analyze

⁴ These are simply two of the many instances of Serpanok's and Hutchinson's misconduct. At the Hearing, the Arbitrator reviewed extensive, undisputed evidence of a pattern of misconduct throughout Hutchinson's employment. Although the Point Ruston Parties are not asking this Court to weigh or to reach any findings based upon this evidence, a chronology of the evidence of Serpanok's and Hutchinson's misconduct that was presented to the Arbitrator is included in the Clerk's Papers. *See* CP at 1255–73.

whether the Garage and Building 1A subcontracts grew immediately out of Serpanok's illegal payments to Hutchinson. CP at 1177–80.

To be clear, the Point Ruston Parties are not asking this Court to reweigh the evidence: They are asking for a remand instructing the Arbitrator to use the correct “grow out of” standard to evaluate whether the contracts are enforceable and for an instruction that illegal contracts are not enforceable as a matter of public policy. *Based on the facts that the Arbitrator has already found*, the contracts are illegal under the “grow out of” standard applied in *Amtruck*. *See Amtruck*, 59 Wn. App. at 21 n.3; *see also id.* at 22 (“Here too, the issue of whether the freight agreements are enforceable is inextricably intertwined with IFP’s counterclaims against Amtruck. Until the jury has resolved the issue of whether Amtruck participated, either intentionally or negligently, in an illegal kickback scheme, the question of whether the freight agreements are void for illegality cannot be resolved.”). The Point Ruston Parties therefore request that, to the extent the Court reverses the Superior Court with instructions to return this case to the Arbitrator, the Court also provide specific instructions that the “grow out of” standard is different (and broader) than the proximate cause standard applied in the Award and focuses on the connection between the misconduct and the contracts at issue, not damages. If the Arbitrator applies the correct “grow out of” standard to Serpanok’s conduct—conduct

which he already found “deplorable” and does “not condone”—then the revised Award will have a much different outcome.

In short, the Award incorrectly applied a proximate cause standard, which is narrower than the applicable “grow out of” standard, to the Point Ruston Parties’ illegality affirmative defense. This was a critical legal error on the face of the Award that requires vacation under RCW 7.04A.230(1)(d). It was also an error that shows internal inconsistencies with the Award’s finding of illegal behavior, and the result otherwise contravenes Washington’s clear-cut public policy against enforcing contracts tainted by illegality or corruption. As such, the Point Ruston Parties respectfully request that the Court reverse the Superior Court’s order confirming the Award with instructions to remand the case to the Arbitrator for application of the “grow out of” standard.

iii. The Award erred by ruling that the Point Ruston Parties had waived their illegality defense.

The Award additionally contains a facial legal error to the extent it concludes the Point Ruston Parties ratified the subcontracts at issue in this case, thereby waiving their illegality defense. In denying the Point Ruston Parties’ fraud counterclaim, the Award stated the Point Ruston Parties “chose...to ratify and insist upon continued performance of the two subcontracts.” CP at 1159. The Award then reiterated this conclusion when

rejecting the Point Ruston Parties' illegality defense. CP at 1178. Any finding that the Point Ruston Parties waived their illegality defense by ratifying the contracts at issue is contrary to Washington law.

“The nonenforcement of illegal contracts is a matter of common public interest, and a party to such contract cannot waive his right to set up the defense of illegality.” *Reed*, 27 Wn. at 55. A party sued under an illegal contract “cannot waive the defense [of illegality] if he wishes to do so.” *Sinnar v. Le Roy*, 44 Wn.2d 728, 729, 270 P.2d 800 (1954) (emphasis added); see also *Sherwood & Roberts-Yakima, Inc. v. Leach*, 67 Wn.2d 630, 639, 409 P.2d 160 (1965) (quoting *Reed* and concluding “appellant’s argument of...waiver is without legal basis” because a party to an illegal contract “cannot waive his right to set up the defense of illegality”); *Kessler v. Jefferson Storage Corp.*, 125 F.2d 108, 110 (6th Cir. 1941) (“It is a well established rule that a contract against public policy cannot be made valid by ratification.” (emphasis added)). The Point Ruston Parties cannot be said to have waived their illegality defense, especially in light of the Arbitrator’s finding that the parties did not consent to or ratify Hutchinson’s acceptance of bribes during his entire tenure as Construction Manager. CP at 1171. This is another legal error on the face of the Award that requires it to be vacated under RCW 7.04A.230(1)(d).

2. The Award’s ruling that the Point Ruston Parties were required—but failed—to prove damages resulting from Serpanok’s kickbacks is a legal error on its face.

The Superior Court additionally erred in confirming and refusing to vacate the Award’s erroneous legal holding that the Point Ruston Parties must prove damages proximately caused by Serpanok’s kickback scheme to support an illegality defense, and that they did not prove damages sufficient to support several tort-based counterclaims. CP at 1159–60,

1165. According to *Black’s Law Dictionary*, a “kickback” is:

A sum of money illegally paid to someone in authority, esp. for arranging for a company to receive a lucrative contract; esp. a return of a portion of a monetary sum received, usu. as a result of coercion or a secret agreement <the contractor paid the city official a 5% kickback on the government contract>.

Black’s Law Dictionary, “kickback” (11th ed. 2019). Here, the Award contained the explicit finding that:

The evidence presented established, by a preponderance of the evidence, that approximately \$80,000 was paid to Mr. Hutchinson [a person in authority] by Serpanok during the relevant two year period for the improper purpose of attempting to procure favorable change order accommodations, induce Hutchinson to share confidential PR information improperly with Serpanok, and assist Serpanok in submitting change order pricing estimates...or for the purpose of rewarding Mr. Hutchinson for his reports that he had engaged or would engage in such conduct.

CP at 1171. In other words, the Award found Serpanok paid Hutchinson \$80,000 in kickbacks relating to the two subcontracts at issue. CP at 1171.

Yet the Award nevertheless found that the Point Ruston Parties could not succeed on their counterclaims for (1) fraudulent inducement and (2) breach of the duty of good faith and fair dealing because they did not prove damages stemming from Serpanok's misconduct. CP at 1159–60, 1165. This is plain legal error apparent on the face of the Award. Established Washington law makes clear that victims of a kickback scheme *do not* have to prove damages stemming from that scheme to obtain a finding of fraud—they suffer damages as a matter of law:

[A] business whose employees receive kickbacks suffers hidden economic losses. When a supplier of goods or services pays kickbacks in order to retain a customer's business, *it is apparent that the supplier is willing to do the job for less than the amount actually billed to the customer.* Whether or not the price paid by the customer is commercially reasonable, *the customer suffers actual damage* in the amount of the kickbacks paid to its employee by the supplier.

Amtruck, 59 Wn. App. at 15 (emphasis added). As a matter of law, “it is not necessary to show out-of-pocket loss in order to prove damages where a kickback scheme is alleged.” *Id.* (emphasis added).

Amtruck is not an aberration—courts throughout the country have recognized that victims of kickback schemes are not required to prove actual damages to succeed on various claims and to prove illegality defenses. *See Dorsett Carpet Mills v. Whitt Title & Marble Distrib. Co.*, 734 S.W.2d 322, 326 (Tenn. 1987) (holding the defendant victim of a kickback scheme was

damaged as a matter of law because “it may be presumed that [the kickbacks] would have inured to the benefit of [the defendant] in the form of lower prices or greater commissions”); *Phillips*, 440 So.2d at 1294 (Fla. Dist. Ct. App. 1983) (rejecting the argument that the victim of a kickback scheme was required to prove “it had suffered an out-of-pocket loss,” explaining “it is beside the point...to say that [the victim] suffered no damages because it received full value for what it has paid and agreed to pay” (quoting *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942))). Not only did the Award fail to apply the correct standard, the Award (and the Superior Court) did not even mention *Amtruck*. See generally CP at 1146–91. This is legal error, and the failure to apply *Amtruck* has a significant, detrimental impact in this case.

First, by failing to apply *Amtruck*, the Award incorrectly concluded the Point Ruston Parties did not prove their fraudulent inducement counterclaim. For the period of time during which Hutchinson worked for the Point Ruston Parties—what the Award called the “reasonable reliance time period”—the Award’s *only* justification for denying this claim was the lack of damages. CP at 1158–61 & n.3 (explaining the “points on which I find the evidence to have been lacking” were “actual and reasonable reliance and ‘consequent damage’”). This holding is contrary to *Amtruck*.

This misapplication of the standard is critical: Fraudulent inducement is not simply a counterclaim, but also an affirmative defense rendering a contract unenforceable. Although the Award expressed concerns about whether it “was reasonably possible, at this late date, to restore the *status quo ante*,” CP at 1159 n.2, fraudulent inducement “is a complete defense” to breach of contract, even when rescission is impossible. *Reed v. Reeves*, 160 Wn. 282, 286, 294 P. 995 (1931) (affirming fraudulent inducement “purely as a legal defense”). Had the Award applied the correct legal standard, it would have found in favor of the Point Ruston Parties on their fraudulent inducement counterclaim and refused to enforce the subcontracts at issue in this case. *See Amtruck*, 59 Wn. App. at 15 (reversing dismissal of fraud counterclaim stemming from kickback scheme for failure to show damages).

Second, the Award erred in rejecting the Point Ruston Parties’ counterclaim for breach of the duty of good faith and fair dealing. Again, the Award’s only justification for denying this counterclaim was the Point Ruston Parties’ failure to show damages. CP at 1165. Proving a breach of the duty of good faith and fair dealing requires only “(1) a duty imposed by the contract that (2) was breached, with (3) damages proximately caused by the breach.” CP at 1165 (quoting *Cacchiotti Props, LLC v. Phillips*, 200 Wn. App. 1001 (2017)). The face of the Award unquestionably

demonstrates that the first two elements are met. CP at 1171; *see also Scribner v. Worldcom, Inc.*, 249 F.3d 902, 910 (9th Cir. 2001) (“[S]ubterfuges and evasions violate the obligation of good faith....”).⁵ The Award’s rejection of this counterclaim hinged entirely on its conclusion that the Point Ruston Parties had not shown damages. But, again, this holding is incorrect under *Amtruck*. *See Amtruck*, 59 Wn. App. at 15.

The Superior Court should not have confirmed the Award’s incorrect legal conclusion that the Point Ruston Parties—the victims of Serpanok’s kickback scheme—must prove additional out-of-pocket damages stemming from that scheme.

3. A public policy tort is a viable Washington claim.

The Award denied the Point Ruston Parties’ public policy tort counterclaim because it was not “clearly established that Washington law recognizes the existence of the ‘public policy torts’ on which this counterclaim depends, or that Washington law permits a private right of action to assert such a civil law tort claim.” CP at 1173. The Award

⁵ Courts have repeatedly recognized that the payment of kickbacks violates the duty of good faith and fair dealing. *See Coosemans Specialties, Inc. v. Dep’t of Agric.*, 482 F.3d 560, 565 (D.C. Cir. 2007) (“[O]ne party to a transaction violates a duty to the other party when it secretly bribes the latter’s agents.”); *JSG Trading Corp. v. Dep’t of Agric.*, 235 F.3d 608, 615 (D.C. Cir. 2001) (“No reasonable conception of honesty or fair dealing includes secret payments designed to corrupt a produce buyer’s agents.”); *Black v. MTV Networks, Inc.*, 576 N.Y.S.2d 846, 848 (1991) (“[C]oncealment of [payments] from the principal, in and of itself, violates the covenant of fair dealing and good faith.”).

declined to grant relief “until the courts have resolved this issue more clearly,” finding that “[t]his uncertainty is appropriately a matter for the courts of this state, rather than a private arbitrator, to resolve.” *Id.*

The Award’s appeal for judicial guidance is “an issue of law apparent on the face of the award, making it a proper subject of a motion to vacate.” *Norberg*, 101 Wn. App. at 125. In *Norberg*, the arbitration award at issue noted “sparse law” on a key legal issue and stated the arbitrators wanted to ensure their award could be reviewed by appellate courts. *Id.* at 124–25. The Court of Appeals emphasized that the “arbitrators chose not to shield from judicial scrutiny the component of their decision that they recognized as a novel legal issue,” and held that it was proper to vacate an arbitration award with instructions regarding that novel legal issue. *Id.* at 125. The same should result here.

The Point Ruston Parties respectfully request that this Court recognize a public policy tort right of action for victims of commercial bribery. The Washington Supreme Court has previously recognized the public’s right to “protection under a public policy tort” where the plaintiff “establish[es] that the public policy is clearly legislatively or judicially recognized.” *Becker v. Cmty. Health Sys., Inc.*, 184 Wn.2d 252, 260–61, 359 P.3d 746 (2015) (recognizing “a public policy tort” against retaliation for complying with the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1514A).

Here, RCW 9A.68.060 clearly recognizes the Washington Legislature's public policy against commercial bribery and provides the elements for a commercial bribery tort under Washington law.

The Point Ruston Parties urge this Court to follow the Florida courts, which have expressly adopted a private tort right of action for commercial bribery. Florida courts recognize that “[a] person who intentionally causes a servant or other agent to violate a duty to the principal is subject to liability in tort.” *Morgan*, 440 So. 2d at 1295; *Excel Handbag Co. v. Edison Bros. Stores*, 630 F.2d 379, 386 (5th Cir. 1980) (describing the elements of this tort as “secret payments to an agent inducing the purchase of goods...from the party making those payments”). As a remedy for this commercial bribery tort, “both the employee and the third party are liable to the employer for the profits ‘earned’ through the arrangement, and...the co-conspirator is barred from recovering for goods sold” to the victim. *Morgan*, 440 So. 2d 1293.⁶

The Award's denial of the Point Ruston Parties' public policy tort counterclaim on the basis of judicial deference constitutes a legal error on the face of the Award. *Norberg*, 101 Wn. App. at 125. If this error is

⁶ As in Florida, the Court should recognize that the remedy for a commercial bribery tort requires disgorgement of the millions in profit that Serpanok already received through its kickback scheme.

corrected and this public policy tort is recognized, it would have a very significant impact on the arbitration's outcome. The Point Ruston Parties therefore respectfully submit that this Court should recognize a private right of action for the victims of commercial bribery and vacate the Award with instructions to apply the law accordingly.

4. The Arbitrator exceeded his authority when he issued an Award that violates clearly established Washington public policy.

It is long-established Washington public policy that courts do not condone corrupt and fraudulent acts like bribery and kickbacks and they will not lend their aid to the perpetrators of these acts. This public policy is consistently expressed in Washington case and statutory law. Washington courts do not enforce illegal contracts, instead leaving the parties where it finds them. *Golberg*, 96 Wn.2d at 879. Washington courts also do not condone illegal kickbacks by requiring victims of a kickback scheme to prove actual damages. *Amtruck*, 59 Wn. App. at 14. Similarly, the Washington Legislature has recognized that commercial bribery *is a felony* and will not be countenanced. RCW 9A.68.060. The same public policy prohibiting decision makers from aiding in the enforcement of illegal acts has been grafted onto arbitration proceedings through RCW 7.04A.230(1)(a), which holds that courts *must* vacate arbitration awards procured by corruption, fraud, or other undue means.

This clear public policy against bribery and kickbacks—and against judicial assistance to perpetrators of this misconduct—supersedes any competing policy favoring the finality of arbitration awards. The Washington Supreme Court has recognized that courts can vacate an arbitration award where the award is contrary to an “explicit, well defined, and dominant public policy.” *Kitsap Cty.*, 167 Wn.2d at 431. Although the Court in *Kitsap County* concluded the public policy at issue was not sufficiently clear, here, Washington’s public policy is explicit. *Id.* at 437–38. Both Washington case law and Washington statutory law unequivocally hold that Washington decisionmakers will not condone fraudulent and corrupt conduct such as bribery and kickbacks. *See* RCW 9A.68.060; RCW 7.04A.230(1)(a); *Golberg*, 96 Wn.2d at 879; *Amtruck*, 59 Wn. App. at 14. *Kitsap County* reflects the common-sense notion that Arbitrators do not have the authority to violate Washington public policy.

The Arbitrator violated this established public policy, and in doing so exceeded his authority, when he entered an Award that allows Serpanok to profit from its illegal acts. The Award itself confirms that Serpanok engaged in corrupt, illegal misconduct. During the Arbitration, the Point Ruston Parties presented evidence showing Hutchinson:

- Was the highest ranking construction official at the project; he negotiated and approved lucrative Serpanok change orders, and he

supervised and approved Serpanok's work and progress payments. CP at 1233–45;

- Purported to negotiate subcontracts on behalf of the Point Ruston Parties but secretly prepared Serpanok's bids for those subcontracts (having actual knowledge of the competing bids and the internal budgets), and then instructed Kunitsa to email the bids to the Point Ruston Parties to hide this fact, all the while using his Serpanok email signature. CP at 1517–33;
- Provided Serpanok with internal cost estimates and a bid that one of its competitors had submitted for the Garage, then schemed with Kunitsa about how closely they could undercut the competitor's bid, using the leaked information. CP at 1509–14;
- Took over the negotiation of the Garage subcontract so he could scheme with Kunitsa to capture massive increases in Serpanok's profit when its scope of work on the Garage was drastically reduced but its contract price was not. *See* CP at 1625, 1622; and
- Purported to negotiate, on behalf of the Point Ruston Parties, lucrative change orders that benefited Serpanok. CP at 1302, 1569–73, 1602–04, 1622.

Based on this substantial evidence of Serpanok's and Hutchinson's misconduct, the Award found "Mr. Kunitsa and Mr. Hutchinson engaged in a course of conduct that I found deplorable and do not condone." CP at 1160; CP at 1174 (noting "[a]dditional details of Mr. Kunitsa's misconduct are accurately described in Respondents' Post-Hearing Brief"). The Award additionally found that Serpanok paid Hutchinson approximately \$80,000 for an "improper purpose" and that this immoral behavior amounted to

aiding and abetting Hutchinson's breach of his fiduciary duties to the Point Ruston Parties. CP at 1171.

From before the contracts were executed through the Arbitration Hearing, Serpanok engaged in a pattern and practice of corruption designed to gain an unfair advantage in contract negotiations and bidding, contract performance and oversight, contract modifications, and the fair discovery and presentation of evidence in the contractual dispute-resolution process. The Point Ruston Parties were prejudiced by Serpanok's corruption at every single phase of the parties' relationship. Yet the Award—based on the misapplications of the law described above—did not properly hold Serpanok accountable for its misconduct. Despite making the factual finding that Serpanok engaged in deplorable, illegal conduct, the Award nevertheless enforced contracts growing immediately out of that illegal conduct, awarding Serpanok millions of dollars in damages. Although the Arbitrator required Serpanok to pay the Point Ruston Parties the \$80,000 in kickbacks it paid Hutchinson and the amount of Hutchinson's salary, the Award still allows Serpanok to profit from its illegal scheme. The amounts awarded against Serpanok are a pittance when compared to the millions of dollars in profit Serpanok gained as the result of its misconduct. The Award does nothing "to prevent [] illegal transactions in the future," *GMB*, 39 Wn. App. at 688, and, in fact, has the effect of incentivizing future misconduct

by sending the message that perpetrators of kickback schemes, even when caught, can still make significant profits from those schemes. This is a violation of Washington public policy that supports vacation of the Award. *See Kitsap Cty.*, 167 Wn.2d at 435–36.

D. The Superior Court should have entered judgment for Cohen.

1. The Superior Court committed reversible error when it confirmed and refused to vacate the Award denying Cohen his contractual attorneys’ fees.

The Award recognized that Cohen “prevailed on [Serpanok’s] claim of tortious conversion, the only claim asserted against him.” CP at 1185. Yet the Superior Court nevertheless confirmed and refused to vacate the Award’s finding that Cohen could not recover his contractual attorneys’ fees. This is legal error.

Notwithstanding its—and the Superior Court’s—previous finding that Cohen was subject to the arbitration clause of the subcontract, the Award erred in finding that the same clause does not apply to Cohen for the purpose of fees. CP at 220, 1185. Before the Award was issued, the Superior Court had already held Cohen was subject to the same provision of the contract requiring fees to the prevailing party, while compelling the arbitration of Serpanok’s conversion claim against Cohen because it was “tied directly to the performance of the contract in that it concerns equipment used in the performance of the contract.” CP at 220. The Award

nevertheless found that Cohen is not eligible for attorneys' fees because "he is not a party" to the fee provisions in that very same arbitration clause. CP at 1185. But the Award elsewhere recognized that Cohen is subject to the subcontracts, "adopt[ing] the conclusions reached in the Court Order concerning the claims and parties covered by that Order." CP at 1154. This internal inconsistency justifies vacation of the Award. *Tolson*, 108 Wn. App. 498–99 ("[I]nternal inconsistency amounts to an error of law on the face of the award."). Having determined that the sole claim against Cohen was subject to arbitration under the subcontract's arbitration clause, the Award erred in concluding that, for the purpose of fees, he is not a party to the exact same paragraph (*compare* CP at 1154, *with* CP at 1185), which requires an award of attorneys' fees to the prevailing party.

The Award further erred in holding that Cohen is not the prevailing party on Serpanok's conversion claim because Serpanok substantially prevailed on *other* claims against *other* Point Ruston Parties. CP at 1185–86. Under Washington law, the Award should not have considered claims between other parties when considering Cohen's request for fees against Serpanok. *Cornish College of the Arts v. 1000 Virginia Ltd. Partnership*, 158 Wn. App. 203, 232, 242, P.3d 1 (2010) (Washington courts are "compelled to evaluate not only which party substantially prevailed, but also against whom that party prevailed"). A defendant is the prevailing

party, as a matter of law, when it defeats every claim by the plaintiff. *Agnew v. Lacey Co-Ply*, 33 Wn. App. 283, 654 P.2d 712 (1982).

Agnew involved a successful defendant who—just like Cohen—was denied attorneys’ fees despite being subject to an arbitration agreement stating that the prevailing party “shall be entitled” to its attorneys’ fees. *Id.* On appeal, this Court held an arbitration award contains a legal error on its face, and requires vacation, when it fails to award fees to a prevailing defendant as required by the contract. *Id.* This case mirrors *Agnew*: The subcontract’s arbitration clause requires the award of attorneys’ fees to the prevailing party, and the Award determined that Cohen was the prevailing party when it denied all claims against him. *Id.* at 288 & n.1. Yet the Award still denied Cohen the attorneys’ fees to which he was entitled. CP at 1185–86. The Superior Court’s failure to vacate this portion of the Award was reversible error.

2. The Superior Court committed reversible error by applying sanctions awarded jointly to Cohen as an offset against amounts awarded against another party.

Recognizing Serpanok’s egregious misconduct during the Arbitration, the Award granted a \$500,000 sanction jointly to all Point Ruston Parties. CP at 1188–90. The Superior Court then allocated this sanction as an offset to amounts owed by Defendant Century Condominiums, LLC. *See* CP at 1023 ¶ 7, CP at 2727 ¶ 3. But the Award

did not contain any suggestion that the sanction award should be applied as an offset. *See* CP at 1190. Under Washington law, the Superior Court lacked authority to “confirm” an allocation of proceeds not present in the Award. *See Price v. Farmers Ins. Co. of Wash.*, 133 Wn.2d 490, 497, 946 P.2d 388 (1997) (“A confirmation action is no more than a motion for an order to render judgment on the award previously made by the arbitrators.... If the court does not modify, vacate, or correct the award, the court exercised a mere ministerial duty to reduce the award to judgment.”). In doing so, the Superior Court effectively modified the Award and exceeded the limited grounds for modification set forth in RCW 7.04A.240.

The Superior Court’s unauthorized allocation of the sanctions award is particularly problematic because it deprived Cohen of any proceeds from the sanctions he was jointly awarded. The application of the offset of judgments is controlled by equitable principles. *Reichlin v. First Nat. Bank*, 184 Wn. 304, 313, 51 P.2d 380 (1935). The Superior Court’s failure to award any portion of the sanctions to Cohen violates equitable principles and was an abuse of the Superior Court’s discretion.

Cohen prevailed on every claim against him, yet he was deprived any monetary award in this case. Instead of granting Cohen even a portion of the sanctions he was awarded, the Superior Court applied the entire amount as an offset to amounts owed by a different defendant. *See* CP at

1023 ¶ 7, CP at 2727 ¶ 3. This was an abuse of discretion. The Superior Court did not have the discretion to apply the sanctions as an offset, and in doing so prevented prevailing party Michael Cohen from recovering any of the money awarded to him. This Court should reverse the Superior Court's decision to apply the \$500,000 sanctions award as an offset.

VI. CONCLUSION

For the foregoing reasons, the Point Ruston Parties respectfully request that the Court reverse the Superior Court's orders confirming and refusing to vacate the Award with instructions to return this case to the Arbitrator for application of the correct legal standards.

VII. REQUEST FOR ATTORNEYS' FEES

The Point Ruston Parties and Cohen request their attorneys' fees pursuant to RAP 18.1. Numerous authorities permit recovery of appellate expenses, including the Garage and Building 1A construction subcontracts (CP 1561 & CP 1661), promissory notes guaranteeing the construction subcontracts (CP 1707 & 1735), and the mechanics' lien statute, RCW 60.04.181(3). Those authorities, quoted at length in CP 1183, require an award of fees and costs to Cohen and the Point Ruston Parties. *See* RCW 4.84.330 (requiring bilateral enforcement of fee provisions); *Ur-Rahman v. Changchun Dev., Ltd.*, 84 Wn. App. 569, 576, 928 P.2d 1149 (1997).

Respectfully submitted this 24th day of June, 2020.

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CERTIFICATE OF SERVICE

I declare that on June 24, 2020, I caused a true and correct copy of the foregoing **Point Ruston Parties' Amended Opening Brief** to be served on the following in the manner indicated:

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

Dated this 24th day of June, 2020.

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Comments:

Amended Opening Brief to provide more detailed Table of Contents for the Court. Only the TOC has been revised, to expand and list the subheadings (and sub-subheadings) in the brief. Nothing in the brief itself has changed.

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