

FILED

JAN 24 2014

COURT OF APPEALS  
DIVISION III  
STATE OF WASHINGTON

COURT OF APPEALS OF THE STATE OF WASHINGTON  
DIVISION III

No. 31904-1-III

---

DOUG and DUSTY CANNON, Plaintiffs/Respondents

v.

COOK CUSTOM HOMES, a Washington corporation,

and

HOWES QUALITY DEVELOPMENT COMPANY, a  
Washington corporation, Defendants,

and

WESTERN HERITAGE INSURANCE COMPANY,  
Intervenor/Appellant.

---

BRIEF OF APPELLANT/INTERVENOR WESTERN  
HERITAGE INSURANCE COMPANY

---

Mark Thorsrud, WSBA #7951  
Russell C. Love, WSBA #8941  
Thorsrud Cane & Paulich  
1325 Fourth Avenue, Suite 1300  
Seattle, WA 98101  
206-386-7755  
[mthorsrud@tcplaw.com](mailto:mthorsrud@tcplaw.com)  
[rlove@tcplaw.com](mailto:rlove@tcplaw.com)

Attorneys for Western Heritage Insurance Co.

## Table of Contents

Table of Contents.....	i
Table of Authorities.....	iv
I. Preliminary Statement and Questions Presented.....	1
II. Assignments of Error.....	2
III. Statement of the Case.....	4
A. Howes develops a subdivision using fill .....	4
B. Cannons buy a lot and contract for house construction.....	5
C. Cannons discover cracks; Cook attempts repairs .....	6
D. The Cannons sue Cook and Howes.....	8
E. Western Heritage defends Cook under a reservation of rights.....	9
F. Geotechnical report shows poorly compacted soils; Howes' geotech has different theory .....	9
G. The parties attempt settlement but impediments exist .....	11
H. Cook and Cannons settle by a covenant judgment and a covenant not to execute.....	12
I. Cannons seek a reasonableness determination; the court denies discovery .....	13
J. The trial court finds the settlement reasonable and enters findings.....	14

K. The trial court denies reconsideration .....	15
L. Western Heritage appeals.....	16
IV. Argument.....	16
A. This court reviews the trial court’s determination of the settlement’s reasonableness for abuse of discretion .....	16
1. The <i>Glover</i> factors guide the court’s evaluation of the reasonableness of a settlement .....	16
2. This court reviews reasonableness determinations for abuse of discretion .....	17
B. The settlement is not reasonable because it includes damage amounts not recoverable as a matter of law ...	18
1. Consideration of the Cannons’ damages requires the court to consider the proper measure of damages .....	18
2. The settlement included all damages the Cannons maintained they could recover .....	18
3. The trial court erred in including stigma damages because the Cannons were fully compensated by full repair costs; an award of stigma damages was disproportionate .....	19
4. The trial court erred in including prejudgment interest because the amounts on which it awarded prejudgment interest are not liquidated amounts.....	24
a. Prejudgment interest cannot be allowed because a reasonableness hearing calls for an exercise of judicial discretion ...	24

b.	Prejudgment interest on the stigma damages is not permissible because the damages were not liquidated.....	25
c.	Prejudgment interest on the unliquidated loss-of-use claim cannot be allowed ....	28
5.	The trial court abused its discretion in allowing attorney fees as part of a reasonable settlement when those fees were not recoverable as a matter of law .....	30
C.	The trial court abused its discretion in finding the settlement reasonable despite evidence of collusion and Cook’s inability to pay .....	38
D.	The trial court abused its discretion in denying Western Heritage discovery focused on the negotiation of the settlement .....	43
V.	Conclusion .....	47

## Table of Authorities

### Federal Court Cases

<i>Aspen Grove Owners Ass'n. v. Park Promenade Apartments, LLC</i> , 842 F. Supp. 2d 1298 (W.D. Wash. 2012) .....	17, 40
<i>Canopy Corp. v. Symantec Corp.</i> , 395 F.Supp.2d 1103, 1114-15 (D.Utah 2005) .....	36

### State Court Cases

<i>Andrade v. Jennings</i> , 54 Cal. App. 4 <sup>th</sup> 307, 62 Cal. Rptr.2d 787 (1997).....	41
<i>Besel v. Viking Ins. Co.</i> , 146 Wn.2d 730, 739 n. 2, 49 P.3d 887 (2002) .....	17, 40
<i>Bird v. Best Plumbing Group, LLC</i> , 175 Wn.2d 756, 774, 287 P.3d 551 (2012) .....	17
<i>Cedell v. Farmers Ins. Co. of Washington</i> , 176 Wn.2d 686, 695, 295 P.3d 239 (2013).....	44
<i>Chausee v. Maryland Cas. Co.</i> , 60 Wn. App. 504, 510, 803 P.2d 1339 (1991) .....	16
<i>Colonial Pipeline Co. v. Nashville &amp; E.R.R.</i> , 253 S.W.3d 616, 619 & 624 (Tenn.Ct.App. 2007) .....	36
<i>Coulter v. Asten Group, Inc.</i> , 155 Wn. App. 1, 13, 230 P.3d 169 (2010) .....	24, 25
<i>Dayton v. Farmers Ins. Group</i> , 124 Wn. 2d 277, 280, 876 P.2d 896 (1994) .....	30
<i>Glover v. Tacoma General Hospital</i> , 98 Wn.2d 708, 718, 658 P.2d 1230 (1983).....	22

<i>Hegwine v. Longview Fibre Co.</i> , 162 Wn.2d 340, 353, 172 P.3d 688 (2007) .....	22
<i>Hooper Associates, Ltd. v. AGS Computers, Inc.</i> , 74 N.Y.2d 487, 548 N.E.2d 903, 549 N.Y.S.2d 365 (1989) .....	36
<i>In Re Det. of Halgren</i> , 156 Wn.2d 795, 802, 132 P.3d 714 (2006) .....	44
<i>Jones v. Strom Constr. Co., Inc.</i> , 84 Wn.2d 518, 523, 527 P.2d 1115 (1974) .....	34, 36
<i>Local 1296, International Assn. of Firefighters v. Kennewick</i> , 86 Wn.2d 156, 161-62, 542 P.2d 1252 (1975).....	22
<i>Mayer v. Sto Indus., Inc.</i> , 156 Wn.2d 677, 684, 132 P.3d 115 (2006) .....	18, 23
<i>Midtown Ltd. Partnership v. Preston</i> , 69 Wn. App. 227, 232, 848 P.2d 1268, <i>review denied</i> , 122 Wn.2d 1006 (1993) .....	22
<i>Moulden &amp; Sons, Inc. v. Osaka Landscaping Nursery, Inc.</i> , 21 Wn. App. 194, 197 n. 5, 584 P.2d 968 (1978) .....	22
<i>Mutual of Enumclaw Ins. Co. v. T&amp;G Construction</i> , 165 Wn.2d 255, 264, 199 P.3d 376 (2008).....	16
<i>NevadaCare, Inc. v. Dept. of Human Services</i> , 783 N.W.2d 459, 471, (Iowa 2010) .....	36
<i>Newport Yacht Basin Ass'n of Condominium Owners v. Supreme Northwest, Inc.</i> , 168 Wn. App. 86, 285 P.3d 70 (2012), <i>review denied</i> , 175 Wn.2d 1015 (2012).....	32, 33, 36
<i>PacifiCorp. v. SimplexGrinell, LLP</i> , 256 Or. App. 665, 303 P.3d 949 (2015) .....	36

<i>Pugel v. Manheimer</i> , 82 Wn. App. 688, 692, 922 P.2d 1377 (1996) .....	20
<i>Safeco Ins. Co. of Am. v. Parks</i> , 170 Cal. App. 4 <sup>th</sup> 992, 88 Cal. Rptr.2d 730, 748 (2009).....	41
<i>Schmidt v. Cornerstone Investments, Inc.</i> , 115 Wn.2d 148, 158, 795 P.2d 1143 (1990) .....	22
<i>State v. Thetford</i> , 109 Wn.2d 392, 396, 745 P.2d 496 (1987) .....	21
<i>Tri-M Erectors, Inc. v. Donald M. Drake Co.</i> , 27 Wn. App. 529, 532, 618 P.2d 1341 (1980) .....	35, 36
<i>Washington State Physicians Ins. Exch. v. Fisons Corp.</i> , 122 Wn.2d 299, 339, 858 P.2d 1054 (1993) .....	17
<i>Water's Edge Homeowners Ass'n. v. Water's Edge Assocs</i> , 152 Wn. App. 572, 585, 216 P.3d 1110 (2009) .....	16
<i>Werlinger v. Warner</i> , 126 Wn. App. 342, 351, 109 P.3d 22, <i>review denied</i> , 155 Wn.2d 1025 (2005) .....	17, 40

**Court Rules**

CR 26.....	43
------------	----

**Other Authorities**

Restatement (Second) of Contracts §348 (1981).....	29
--	----

## I. Preliminary Statement and Questions Presented

The Cannons sued Cook, their home builder, and Howes, the developer who had imported large amounts of fill onto the land on which the house was built, for damage to their house caused by subsidence. After discovery, Cannons unsuccessfully demanded about \$550,000 in settlement from both defendants. The Cannons then settled with Howes for \$400,000, gave Cook a covenant not to execute on assets other than insurance, and Cook then stipulated to a judgment for \$1.3 million. The target of that judgment was Western Heritage, Cook's liability insurer that had defended it under a reservation of rights.

The Cannons asked the trial court to find the \$1.3 million covenant judgment reasonable. Western Heritage intervened and asked for discovery focused on the settlement process. The trial court denied discovery, and over Western Heritage's opposition, found the settlement reasonable.

This appeal calls upon the court to decide these questions:

Settlement reasonableness issue: The \$1.3 million settlement included over \$800,000 of stigma damages, prejudgment interest and attorney fees. Stigma damages may not be awarded in addition to repair costs and loss-of-use (already included), prejudgment interest is

available only on liquidated amounts and the stigma and loss-of-use damages were not liquidated, and the construction contract did not contain a prevailing-party attorney fees provision. Did the trial court abuse its discretion in finding the settlement reasonable?

Collusion issue: A covenant not to execute raises a “specter of collusive settlement.” Cook’s counsel estimated Cook’s exposure at around \$150,000 to \$350,000; once given a covenant not to execute, however, Cook agreed to a \$1.3 million settlement, including \$800,000 of non-recoverable damages. Did the trial court abuse its discretion in concluding there was no evidence of collusion?

Discovery issue: Western Heritage sought discovery on collusion in the settlement negotiation process; no discovery on that topic had occurred. Even though “the right to discovery is an integral part of the right to access to the courts,” the trial court denied the request because much discovery had been done on other topics. Did the trial court abuse its discretion in denying discovery on this undiscovered topic?

## II. Assignments of Error

1. The trial court erred in denying Western Heritage’s request for specific discovery on collusion prior to the court’s ruling on the motion for reasonableness determination. (CP 1028-1030)

2. The trial court erred in finding the settlement reasonable, erred in entering the findings of fact and conclusions

of law, and specifically erred in making these findings: (CP 1428-1436)

- a. Finding of fact paragraph 1, which states a legal conclusion;
- b. Finding of fact paragraph 3; which states a legal conclusion;
- c. Finding of fact paragraph 5, which states a legal conclusion;
- d. Finding of fact paragraph 6, which states a legal conclusion;
- e. Finding of fact paragraph 7, which states legal conclusions and a fact not supported by the evidence;
- f. Finding of fact paragraph 8, which states legal conclusions and facts not supported by the evidence;
- g. Finding of fact paragraph 9, which states erroneous legal conclusions;
- h. Finding of fact paragraph 11, which states legal conclusions;
- i. Finding of fact paragraph 12, which states an erroneous legal conclusion;
- j. Finding of fact paragraph 13, which states legal conclusions and facts not supported by evidence;
- k. Finding of fact paragraph 14, which states legal conclusions and facts not supported by the evidence;

l. Finding of fact paragraph 15, which states legal conclusions and facts not supported by evidence;

m. Finding of fact paragraph 16, which states legal conclusions;

n. Finding of fact paragraph 17, which states facts not supported by evidence and states legal conclusions;

o. Finding of fact paragraph 18, which states legal conclusions;

p. Conclusion of law paragraph 1, which states an erroneous legal conclusion;

q. Conclusion of law paragraph 2, which states an erroneous legal conclusion; and

r. Conclusion of law paragraph 3, which states an erroneous legal conclusion.

3. The trial court erred in entering the judgment against Cook. (CP 1437-1439)

4. The trial court erred in denying Western Heritage's motion for reconsideration. (CP 1474 – 1476)

### III. Statement of the Case

A. Howes develops a subdivision using fill.

Between 1997 and 2005 Howes Quality Development Company developed the Forest Hills Fourth Edition subdivision

in Spokane.<sup>1</sup> Around the fall of 2003 during Howes' work a substantial amount of fill – a depth of about 35 to 38 feet – was placed on the property.<sup>2</sup> Some of the fill apparently contained native materials such as trees, shrubs and branches.<sup>3</sup> The evidence does not show that Howes obtained the necessary permitting to do the grading and fill work.<sup>4</sup> As part of the development Howes constructed building pads and sold the lots.<sup>5</sup>

**B. Cannons buy a lot and contract for house construction.**

Howes sold one of the lots to a Ms. Resberg. In August 2005 Doug and Dusty Cannon purchased that lot from Ms. Resberg for \$107,000.<sup>6</sup> The Cannons provided architectural plans to and contracted with Cook Custom Homes, Inc. for the construction of a residence on their lot at a contract price of \$269,236.<sup>7</sup> The construction contract stated that the “excavation

---

<sup>1</sup> CP 24.

<sup>2</sup> CP 143, 157-158, 509, 557-558, 561-582, 635, 640, 1094.

<sup>3</sup> CP 24, 291-293.

<sup>4</sup> CP 1060-1062.

<sup>5</sup> CP 290.

<sup>6</sup> CP 782, 757, 290.

<sup>7</sup> CP 21, 41, 42, 1150, 290.

of the lot and subsequent foundation were based on the report and verbal information from Greg Miller with Romer & Associates LLC. The report indicated ‘a . . . compacted fill building envelope, sufficient to build this home’.”<sup>8</sup>

Cook started work on the home in September 2005 and completed the work by early 2006.<sup>9</sup> According to the Cannons, Cook brought in several hundred yards of fill to expand the home’s foundation, as provided in the architectural plans.<sup>10</sup> The Cannons state that they paid Cook in full for the work.<sup>11</sup>

**C. Cannons discover cracks; Cook attempts repairs.**

The Cannons moved into the home in March 2006. Shortly thereafter they observed cracks throughout the home. A residential inspection in September 2006 noted significant settling cracks in the walls, shifting throughout the siding, and cracks in the basement slab.<sup>12</sup>

---

<sup>8</sup> CP 1150, 1154, 1163-1170.

<sup>9</sup> CP 21.

<sup>10</sup> CP 290, 1057.

<sup>11</sup> CP 21.

<sup>12</sup> CP 22, 782-783.

The Cannons told Cook about these problems and gave it an opportunity to cure the deficiencies. Cook performed repair work from the fall of 2006 to the spring of 2007 when Michael Cook, Cook's president, was injured in an accident.<sup>13</sup> The Cannons claimed that this work failed to resolve the settlement, movement, and related cracking throughout the home.<sup>14</sup> Mr. Cook assured the Cannons that on recovery from his injury he would resume work on their home. But when they contacted Cook in the summer of 2008, they claim he told them his company would not complete the work. Cook invited them to contact his insurer to make a claim for completion of the work.<sup>15</sup> Cook claims it told them that its inability to fix was based on problems with the land, not the construction.<sup>16</sup>

Since that time the settlement has continued, causing further settling and cracking of the foundation, floor heaving, cracking and movement of ceilings, walls and floors, and binding

---

<sup>13</sup> CP 22, 23.

<sup>14</sup> CP 22.

<sup>15</sup> CP 23.

<sup>16</sup> CP 42-43.

of doors and windows. The Cannons later claimed that the house became uninhabitable.<sup>17</sup>

**D. The Cannons sue Cook and Howes.**

In 2010 the Cannons sued Cook and its bonding company, later adding Howes, the developer responsible for the fill, as a defendant.<sup>18</sup> As against Cook they claimed that Cook had breached its contract, had breached the covenant of good faith and fair dealing, was estopped to deny its promises, was unjustly enriched, had been negligent in its construction practices, and had breached the warranty of habitability.<sup>19</sup> They claimed that Howes had been negligent in allowing the use of improper fill material, which had led to the settlement and resulting damage to their home, and that the existence of the improper fill on their lot was a private nuisance. They sought damages from both defendants.<sup>20</sup>

---

<sup>17</sup> CP 23.

<sup>18</sup> CP 5-12, 20-31.

<sup>19</sup> CP 26-29.

<sup>20</sup> CP 29-31.

E. Western Heritage defends Cook under a reservation of rights.

Cook tendered its defense to Western Heritage, its liability insurer under policies in effect from January 2005 to January 2008. Western Heritage agreed to defend Cook under a reservation of rights.<sup>21</sup>

F. Geotechnical report shows poorly compacted soils; Howes' geotech has different theory.

As part of its defense, Cook hired a geotechnical firm, GN Northern, that took several soil-boring samples at the Cannons' home. The geotechnical report showed that the house was situated on "very poorly compacted artificial fill soils" to a depth of about 35 to 38 feet. The report concluded that the developer, Howes, failed to follow proper compaction, fill control, and upper slopes construction procedures during its on-site grading operations. The report noted that "miscellaneous wood and other debris" was encountered during the exploration.<sup>22</sup>

Howes also hired a geotechnical firm, Strata, to investigate. While Strata's report sought to blame Cook for the

---

<sup>21</sup> CP 557-558, 561-582.

<sup>22</sup> CP 583-589, 603-606, 783.

home damage, it confirmed the existence of possibly as much as 20% organic material (such as sticks and branches) in the fill material, the presence of excessively steep slopes, and the poor integration of the fill.<sup>23</sup> But its “preliminary” report theorized that two different fill events – “Fill #1” and “Fill #2” – had occurred, and asserted that the settling problems were attributable to Fill #1, which it claimed had been placed by Cook.<sup>24</sup>

Strata’s theory conflicted with the evidence. No evidence showed that Cook had added any fill until after the house foundation had been constructed. Furthermore, to satisfy Strata’s Fill #1 theory, Cook, as the engineers calculated, would have had to import over 2,600 cubic yards – 238 truckloads – of fill at a cost of over \$20,000. Yet there was no record that Cook had paid for any fill or that he had charged the Cannons for any fill.<sup>25</sup>

---

<sup>23</sup> CP 784.

<sup>24</sup> CP 635-637, 660-669, 1090-1092, 784.

<sup>25</sup> CP 1096, 1175-1182.

Cook's expert supplemented its report, showing a lack of evidence to suggest that any fill was placed by Cook or anyone else after Howes' mass-graded fill in 2003. The supplemental report concluded that "[t]he home's footings are entirely founded and supported on fill soils placed during the mass grading operations conducted [by Howes] in the fall of 2003."<sup>26</sup>

**G. The parties attempt settlement but impediments exist.**

After discovery the parties sought to settle the case. But significant impediments to settlement existed. Howes and Cook disputed their respective liability and liability shares.<sup>27</sup> Defendants also disputed the Cannons' damage calculations and certain elements of their claimed damages.<sup>28</sup> Cook faced significant insurance coverage problems because its liability policies excluded coverage for damage to its own work (i.e., the Cannons' house) and excluded coverage for subsidence damage. Cook had no substantial non-insurance assets.<sup>29</sup>

---

<sup>26</sup> CP 1096-1104.

<sup>27</sup> CP 1060-1064.

<sup>28</sup> CP 1059-1060.

<sup>29</sup> CP 557-582, 1139.

H. Cook and Cannons settle by a covenant judgment and a covenant not to execute.

The parties mediated without success. The Cannons' final settlement demand to both defendants was \$553,406.<sup>30</sup>

Cook's counsel estimated the realistic settlement value at about \$150,000 to \$350,000 and Cook's chances of winning at 50% - 60%. Cook was prepared to prove that Howes faced sole liability because of its improper filling practices in violation of the county codes, and that Cook should recover indemnity from Howes. A few weeks later the Cannons settled with Howes for \$402,000.<sup>31</sup> Then the Cannons eliminated Cook's risk by granting it a covenant not to execute. With that inducement in place, Cook stipulated to a judgment for \$1.293 million. Cook assigned its insurance rights against Western Heritage to the Cannons.<sup>32</sup>

---

<sup>30</sup> CP 835, 861.

<sup>31</sup> CP 1140, 1143-1146, 916.

<sup>32</sup> CP 784, 787-793.

I. Cannons seek a reasonableness determination; the court denies discovery.

The Cannons sent a motion for reasonableness determination to Western Heritage.<sup>33</sup> Western Heritage hired counsel.<sup>34</sup> The Cannons agreed to allow Western Heritage to intervene.<sup>35</sup> Western Heritage asked the court to allow discovery on the settlement. Specifically, Western Heritage sought to depose the Cannons' counsel, Cook's counsel and Mr. Cook on collusion questions.<sup>36</sup> The trial court denied the motion.<sup>37</sup>

The Cannons then brought their reasonableness motion before the court. They claimed their settlement for \$1.293 million – which included the full amount for repair costs, moving expenses, loss-of-use damages, stigma damages, prejudgment interest, and attorneys' fees, in addition to the \$402,000 settlement with Howes – was reasonable.<sup>38</sup> Western Heritage opposed the motion, observing that the settlement as stated,

---

<sup>33</sup> CP 1678

<sup>34</sup> CP 1678.

<sup>35</sup> CP 811-812.

<sup>36</sup> CP 813-820.

<sup>37</sup> CP 1028-1030; RP (6/21/2013) 13-14.

<sup>38</sup> CP 551-553, 794-803.

when combined with the settlement with Howes, would allow the Cannons to recover 30% more than their actual claimed damages. Western Heritage further noted that the settlement awarded the full amount of every damage element and represented no compromise at all. And Western Heritage showed that the settlement included several damage elements – over \$800,000 worth – not recoverable as a matter of law.<sup>39</sup>

The Cannons' reply materials included voluminous declarations attesting to the amount of attorneys' fees and disclosed for the first time that Howes was entitled to be reimbursed out of any recovery from Western Heritage.<sup>40</sup> Western Heritage objected to the presentation of those materials on reply.<sup>41</sup>

**J. The trial court finds the settlement reasonable and enters findings.**

At the reasonableness hearing Western Heritage argued that the settlement was unreasonable and specifically advised the court that the award of prejudgment interest and attorney

---

<sup>39</sup> CP 1031-1044.

<sup>40</sup> CP 1183-1198, 1201, 1229-1237, 1264- 1343.

<sup>41</sup> CP 1346-1348.

fees was legally impermissible.<sup>42</sup> The trial court gave its assessment of each of the reasonableness-hearing factors, and in its words, agreed with the Cannons' "spin," and found the settlement reasonable.<sup>43</sup> The court later entered findings and conclusions finding the settlement reasonable and entered judgment against Cook.<sup>44</sup> The court rejected findings proposed by Western Heritage consistent with the court's oral ruling.<sup>45</sup>

**K. The trial court denies reconsideration.**

Western Heritage moved for reconsideration of the court's order, specifically advising the court of errors of law in the award of prejudgment interest for unliquidated amounts, and the award of attorneys' fees where the contract did not authorize it, and the award of amounts exceeding the Cannons' actual damages.<sup>46</sup> The court denied reconsideration.<sup>47</sup>

---

<sup>42</sup> RP (7/12/2013) 12-24; CP 1398-1410.

<sup>43</sup> RP (7/12/2013) 30-40; CP 1416-1426.

<sup>44</sup> CP 1428-1436; 1437-1439.

<sup>45</sup> CP 1385-1427.

<sup>46</sup> CP 1350-1363; 1453-1459.

<sup>47</sup> CP 1474-1476; 1697-1698.

L. Western Heritage appeals.

Western Heritage timely appealed.<sup>48</sup>

IV. Argument

A. This court reviews the trial court's determination of the settlement's reasonableness for abuse of discretion.

*1. The Glover factors guide the court's evaluation of the reasonableness of a settlement.*

Our Supreme Court has provided a road map of factors – the *Glover* factors – to consider in evaluating a settlement's reasonableness:

- (1) The releasing party's damages;
- (2) The merits of the releasing party's liability theory;
- (3) The merits of the released party's defense theory;
- (4) The released party's relative fault;
- (5) The risks and expenses of continued litigation;
- (6) The released party's ability to pay;
- (7) Any evidence of bad faith, collusion, or fraud;
- (8) The released party's investigation and preparation; and
- (9) The interests of the parties not being released.<sup>49</sup>

---

<sup>48</sup> CP 1460-1473; 1477-1493.

<sup>49</sup> *Mutual of Enumclaw Ins. Co. v. T&G Construction*, 165 Wn.2d 255, 264, 199 P.3d 376 (2008); *Chausee v. Maryland Cas. Co.*, 60 Wn. App. 504, 510, 803 P.2d 1339 (1991).

No single factor controls. All nine factors are not necessarily relevant in every case.<sup>50</sup> The importance of each of the factors varies from case to case.<sup>51</sup>

*2. This court reviews reasonableness determinations for abuse of discretion.*

This court reviews a trial court's reasonableness determination for abuse of discretion.<sup>52</sup> A trial court abuses its discretion when its order is manifestly unreasonable, or is based on untenable grounds or untenable reasons. A trial court necessarily abuses its discretion if it bases its ruling on an incorrect view of the law.<sup>53</sup> "A discretionary decision rests on 'untenable grounds' or is based on 'untenable reasons' if the trial

---

<sup>50</sup> *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 739 n. 2, 49 P.3d 887 (2002); *Water's Edge Homeowners Ass'n. v. Water's Edge Assocs*, 152 Wn. App. 572, 585, 216 P.3d 1110 (2009).

<sup>51</sup> E.g. *Aspen Grove Owners Ass'n. v. Park Promenade Apartments, LLC*, 842 F. Supp. 2d 1298 (W.D. Wash. 2012) (considering certain factors but not others not "significant enough to warrant inclusion in the court's reasonableness determination"); *Werlinger v. Warner*, 126 Wn. App. 342, 351, 109 P.3d 22, *review denied*, 155 Wn.2d 1025 (2005) ("All of the *Glover* factors are not necessarily relevant in every case.").

<sup>52</sup> *Bird v. Best Plumbing Group, LLC*, 175 Wn.2d 756, 774, 287 P.3d 551 (2012).

<sup>53</sup> *Washington State Physicians Ins. Exch. v. Fisons Corp.*, 122 Wn.2d 299, 339, 858 P.2d 1054 (1993).

court relies on unsupported facts or applies the wrong legal standard.”<sup>54</sup>

B. The settlement is not reasonable because it includes damage amounts not recoverable as a matter of law.

*1. Consideration of the Cannons’ damages requires the court to consider the proper measure of damages.*

In this case the starting point must be the first *Glover* factor, i.e., the Cannons’ damages. Any consideration of a claimant’s damages must include not only an analysis of what the claimant alleges, but also the appropriate measure of damages. A settlement amount cannot be reasonable if it includes amounts beyond what the law allows the claimant to recover.

*2. The settlement included all damages the Cannons maintained they could recover.*

The Cannon/Cook settlement – as presented by the Cannons and as found reasonable by the court – included the full value of each of these elements:

---

<sup>54</sup> *Mayer v. Sto Indus., Inc.*, 156 Wn.2d 677, 684, 132 P.3d 115 (2006).

Repair Costs	\$ 396,478.00
Moving Expenses	\$ 15,793.99
Loss-of-Use Damages	\$ 74,229.16
Stigma Damages	\$ 292,500.00
Pre-Judgment Interest on Loss-of-Use and Stigma Damages	\$ 308,052.49
Attorneys' fees and costs	\$ <u>206,839.17</u>
<b>TOTAL</b>	<b>\$ 1,293,892.81<sup>55</sup></b>

These amounts represent the Cannons' best possible result for each of these damage elements. The court's reasonableness determination thus assumes that the Cannons could have recovered each of these damage elements. But, as we show below, that is not so.

*3. The trial court erred in including stigma damages because the Cannons were fully compensated by full repair costs; an award of stigma damages was disproportionate.*

The Cannons claimed nearly \$400,000 in repair costs on a residence initially built for \$269,000, plus moving expenses and

---

<sup>55</sup> CP 796-797.

loss of use – a total of nearly \$490,000.<sup>56</sup> The repair cost included structural engineering and geotechnical work to address the foundation problems and to control future settlement. As the Cannons' counsel stated, this amount would “remedy the structural integrity of the lot under the house and . . . repair the Cannon residence.”<sup>57</sup>

When injury to real property is permanent, “the usual measure of damages is the difference between the value of the land before the injury and immediately after; where the injury is not permanent and the premises can be restored to their original condition, the usual measure of damages is restoration costs and loss of use.”<sup>58</sup> These are alternatives; to award both confers a windfall.<sup>59</sup>

Under the facts here then, the Cannons may not recover stigma damages for two reasons. First, the injury is not permanent because the repair costs address the foundation and

---

<sup>56</sup> CP 796-797; 1150.

<sup>57</sup> CP 558, 736-737.

<sup>58</sup> *Pugel v. Manheimer*, 82 Wn. App. 688, 692, 922 P.2d 1377 (1996).

<sup>59</sup> *Id.*

settlement problems. The proper measure of damages is restoration costs and loss of use. Second, even if the injury is permanent, the correct measure of damages is diminution in market value. Here the Cannons awarded themselves both repair costs including loss-of-use damages and stigma (diminution in value) damages – a total of \$688,978 – an amount clearly disproportionate to the fair market value of the home – \$475,000.<sup>60</sup> It makes no sense to award \$688,978 for damage to a home valued at only \$475,000. The Cannons could recover a maximum of \$475,000.

The trial court's findings do not change this. The court stated in Finding of Fact paragraph 3 that “[t]he cost of repair was not clearly disproportionate to the cost of the diminution in value” and in paragraph 7 that “following repair, the house would have incurred stigma damages.”<sup>61</sup> Findings of fact will not be disturbed on appeal when supported by substantial

---

<sup>60</sup> CP 796-797, 1059, 757.

<sup>61</sup> CP 1430.

evidence.<sup>62</sup> But a “finding of fact” that is in fact a conclusion of law is subject to review as a conclusion of law, that is, de novo.<sup>63</sup> A proper finding of fact determines whether the evidence shows that something occurred or existed. By contrast, a conclusion of law is a determination “made by a process of legal reasoning from, or of interpretation of the legal significance of, the evidentiary facts.”<sup>64</sup> The trial court’s “findings” about disproportionality and about the availability of stigma damages are determinations of the legal significance of unstated facts and are thus conclusions of law. They are therefore subject to this court’s de novo review.<sup>65</sup>

---

<sup>62</sup> *Schmidt v. Cornerstone Investments, Inc.*, 115 Wn.2d 148, 158, 795 P.2d 1143 (1990), citing *Glover v. Tacoma General Hospital*, 98 Wn.2d 708, 718, 658 P.2d 1230 (1983); *State v. Thetford*, 109 Wn.2d 392, 396, 745 P.2d 496 (1987).

<sup>63</sup> *Midtown Ltd. Partnership v. Preston*, 69 Wn. App. 227, 232, 848 P.2d 1268, review denied, 122 Wn.2d 1006 (1993), citing *Local 1296, International Assn. of Firefighters v. Kennewick*, 86 Wn.2d 156, 161-62, 542 P.2d 1252 (1975); *Hegwine v. Longview Fibre Co.*, 162 Wn.2d 340, 353, 172 P.3d 688 (2007).

<sup>64</sup> *Moulden & Sons, Inc. v. Osaka Landscaping Nursery, Inc.*, 21 Wn. App. 194, 197 n. 5, 584 P.2d 968 (1978).

<sup>65</sup> *Hegwine v. Longview Fibre Co.*, 162 Wn.2d 340, 353, 172 P.3d 688 (2007).

The trial court's "no disproportionality" statement identifies no evidentiary facts to support it. The undisputed evidentiary facts showed the value of the house (\$475,000) and the amount of the repair costs and stigma damages (\$688,978).<sup>66</sup> The trial court's "no disproportionality" statement – in fact a conclusion of law – is unsupported by the record facts. It is an abuse of discretion both because it is an incorrect legal conclusion and because it is based on untenable reasons because the facts do not support it.<sup>67</sup>

The trial court's stigma-damages statement fares no better. That statement is also a legal conclusion about whether stigma damages are recoverable in addition to repair costs and loss of use. As shown above, they are not.

Because under these facts, stigma damages are not recoverable as a matter of law, the trial court abused its discretion in finding reasonable a settlement that included those damages.

---

<sup>66</sup> CP. 757, 796-797.

<sup>67</sup> *Mayer*, 156 Wn.2d at 684.

*4. The trial court erred in including prejudgment interest because the amounts on which it awarded prejudgment interest are not liquidated amounts.*

A prevailing party is entitled to prejudgment interest only if (1) the damages are liquidated, meaning that “data in the evidence makes it possible to compute the amount with exactness, without reliance on opinion or discretion,” or (2) when the amount claimed is unliquidated but is determinable by computation with reference to a fixed standard in a contract.<sup>68</sup>

Here the Cannons claim that their stigma and loss-of-use damages are liquidated and therefore prejudgment interest is awardable from March 2006 when they moved into the residence.<sup>69</sup>

*a. Prejudgment interest cannot be allowed because a reasonableness hearing calls for an exercise of judicial discretion.*

As an initial matter, their prejudgment-interest claim – both for the loss-of-use damages and for the stigma damages – must fail because those damages were never liquidated until the

---

<sup>68</sup> *Coulter v. Asten Group, Inc.*, 155 Wn. App. 1, 13, 230 P.3d 169 (2010).

<sup>69</sup> CP 797, 784-785.

court found the amount of those damages reasonable at the July 2013 reasonableness hearing. As Division I of this court has explained, “[a] reasonableness hearing calls for an exercise of judicial discretion.”<sup>70</sup> Consequently, it is impossible to call the award of loss-of-use and stigma damages liquidated because those amounts cannot be calculated “without reliance on opinion or discretion.” Therefore, the court’s allowance of prejudgment interest when the law does not permit it is an error of law and thus an abuse of discretion.

*b. Prejudgment interest on the stigma damages is not permissible because the damages were not liquidated.*

But there is more. The stigma damages are not a liquidated amount for further reasons. The Cannons’ own evidence shows that the amount of stigma damages was an estimated amount. Mr. Cannon’s declaration states that the stigma damages have been “estimated” at “40% to 50%” of their home’s value.<sup>71</sup> This percentage range was based on the opinion

---

<sup>70</sup> *Coulter v. Asten Group, Inc.*, 155 Wn. App. 1, 13, 230 P.3d 169 (2010).

<sup>71</sup> CP 785.

of Jim Powers, a real estate agent with Century 21.<sup>72</sup> The stigma damages relied on opinion and discretion on several levels:

- The court had to exercise discretion to determine whether stigma damages were awardable at all.
- The court had to exercise discretion to determine whether Mr. Powers possessed the qualifications to express an opinion about the amount of stigma damages.
- The court had to exercise discretion to decide whether to accept Mr. Powers' opinion and, if it was accepted, to accept the number of 40%, or 50%, or some percentage in between. (The Cannons arbitrarily applied the 50% number.)<sup>73</sup>
- The court had to exercise discretion about the home appraisal value (itself an opinion figure) to which the opinion percentage range should be applied.<sup>74</sup>

The stigma damages' unliquidated character is most clearly revealed by this stark fact: If awardable at all, the amount of stigma damages – based on the Cannons' own evidence – could be anywhere from \$190,000 (40% of home value of \$475,000) to \$292,500 (50% of home value of \$585,000). As a matter of law, the stigma damages were not a liquidated amount

---

<sup>72</sup> CP 554-555.

<sup>73</sup> CP 797.

<sup>74</sup> CP 757.

and therefore could not be the basis for an award of prejudgment interest. The trial court's determination to the contrary was an error of law and therefore an abuse of discretion.

The trial court's prejudgment interest "findings" do not change this conclusion. The statements that "[t]he loss-of-use and stigma damages are liquidated claims. The prejudgment interest is appropriate as a result"<sup>75</sup> are in fact conclusions of law (determinations of the legal significance of facts) subject to this court's de novo review. The trial court's statement that the stigma damages "were based on undisputed percentages that required a simple calculation"<sup>76</sup> is either a conclusion of law or a finding of fact unsupported by substantial evidence (a range of 40% to 50% is not an undisputed percentage). The same is true of the trial court's statement that "[t]he [stigma] damages at issue here were liquidated because if plaintiffs' evidence were believed, they could be calculated with exactness using a simple calculation."<sup>77</sup> The only evidence – the opinion of the real-estate

---

<sup>75</sup> CP 1431.

<sup>76</sup> CP 1431.

<sup>77</sup> CP 1431.

agent – was that the stigma damages would be in the range of 40% to 50%;<sup>78</sup> that is not a fixed percentage from which a simple calculation can be made; rather it is an estimate based on an opinion. The referenced “findings” cannot be sustained.

Because the stigma damages were not a liquidated amount, the trial court erred as a matter of law and abused its discretion in finding reasonable the prejudgment interest on stigma damages.

*c. Prejudgment interest on the unliquidated loss-of-use claim cannot be allowed.*

The loss-of-use claim was likewise unliquidated. In his declaration Mr. Cannon stated: “We estimate that we have incurred additional damages \$74,299.16 due to the loss of use of 49% of our home . . . . We calculate these damages at \$74,299.16 which amounts to 49% of our mortgage payments from March 2006 to date.”<sup>79</sup> To accept this amount as reasonable, the trial court had to make several assumptions:

- The trial court had to assume that 49% represented the correct percentage for the loss-of-use calculation – when

---

<sup>78</sup> CP 555.

<sup>79</sup> CP 784-785 (emphasis added).

Mr. Cannon's declaration provided no explanation of how that percentage was derived. (For example, if the percentage was based on relative floor areas of the basement and main floor, it would be unreasonable to attach the same value to unfinished basement space as to the finished living space.) The record is inadequate to know whether this figure is reasonable.

- The trial court had to assume that the loss of use began in March 2006 – before Cook had even completed its work – and before any settling problems emerged. The record suggests that the loss of use, if any, could not have begun before September 2006 when the Cannons had the inspection performed or later.<sup>80</sup>
- The court had to assume that the Cannons' use of mortgage payments represented a proper measure of loss. In fact, it is not. Loss of use is typically measured by rental value.<sup>81</sup>

The record is inadequate to show that the loss-of-use calculation has any basis in fact or law. And under any circumstance, the trial court was required to exercise its discretion to determine the foundational facts – that the estimated percentage was correct, that the loss-of-use period was correct, and that the use of mortgage payments as a measure of loss was correct. As a matter of law, the loss-of-use claim was not liquidated; the trial court's "findings" to the

---

<sup>80</sup> CP 782-783.

<sup>81</sup> Restatement (Second) of Contracts §348 (1981).

contrary in paragraph 8 of the findings<sup>82</sup> were legally incorrect and not supported by substantial evidence. The trial court therefore abused its discretion in finding reasonable an award of prejudgment interest on the loss-of-use claim.

*5. The trial court abused its discretion in allowing attorney's fees as part of a reasonable settlement when those fees were not recoverable as a matter of law.*

The Cannons claimed that including their attorneys' fees and costs of \$206,839.17 in the settlement amount was reasonable. This was so, they claimed, because their construction contract with Cook authorized an award of attorneys' fees.<sup>83</sup> The trial court agreed.<sup>84</sup> This, too, was an error of law.

In Washington attorney's fees may be recovered in a suit only when authorized by statute, contract or equity.<sup>85</sup> No statutory or equitable basis supports an award of fees here. Moreover, the construction contract contains no prevailing-party

---

<sup>82</sup> CP 1431.

<sup>83</sup> CP 797, 1197.

<sup>84</sup> CP 1431.

<sup>85</sup> *Dayton v. Farmers Ins. Group*, 124 Wn. 2d 277, 280, 876 P.2d 896 (1994).

attorney's fees provision. The Cannons nevertheless seek to justify the attorney's fees component on the contract's indemnity provision:

**Article 6. Indemnification**

To the fullest extent permitted by law, the Contractor shall indemnify, defend and hold harmless Doug & Dusty Cannon \_\_\_\_\_ and its agents and employees, from and against all claims, damages, losses and expenses, including but not limited to attorney's fees, arising out of or resulting from performance of the work or providing of materials to the extent caused in whole or in part by negligent or wrongful acts or omissions of, or a breach of this agreement by, the contractor, a subcontractor, anyone directly or indirectly employed by them or anyone whose acts they are legally responsible [sic].<sup>86</sup>

This indemnity clause is worded to require the contractor to defend and indemnify the Cannons "against" all claims and losses including attorney's fees. That is, it requires Cook to reimburse the Cannons if claims are asserted against them arising from Cook's work. It does not require Cook to finance the Cannons' claim against Cook – it is not a prevailing-party clause that would shift fees to the winner in a dispute between the

---

<sup>86</sup> CP 1150-1151.

parties to the contract. Prevailing-party clauses are common, but this contract does not contain one.

*Newport Yacht Basin* concerned an agreement containing both a prevailing-party clause and an indemnification clause, illustrating that these two types of clauses serve different purposes.<sup>87</sup> The agreement contained a typical prevailing-party clause providing for recovery of attorney's fees as costs:

In the event any action or proceeding is brought by either party against the other related to this Agreement, the substantially prevailing party shall be entitled to recover from the other party its costs, including but not limited to reasonable attorneys' fees, incurred in such action or proceeding, including any appeal, which amounts shall be included in any judgment entered in such action or proceeding.<sup>88</sup>

The court in *Newport Yacht Basin* noted in a footnote that “It is significant that the parties contracted to treat attorney fees as ‘costs.’ This is typical of such provisions and distinguishes the

---

<sup>87</sup> *Newport Yacht Basin Ass'n of Condominium Owners v. Supreme Northwest, Inc.*, 168 Wn. App. 86, 285 P.3d 70 (2012), *review denied*, 175 Wn.2d 1015 (2012) (overturning award of attorney's fees).

<sup>88</sup> *Newport Yacht Basin*, 168 Wn. App. at 98.

claim of entitlement to an award of such fees from an action for indemnification, discussed *infra*."<sup>89</sup>

The indemnification clause in *Newport Yacht Basin* was worded differently:

Seller [Radovich] hereby agrees to indemnify and hold Purchaser [Burbridge/Bridges] harmless from: [listed claims] ... and (c) all actions, suits, proceedings, demands, assessments, judgments, costs and expenses connected with the foregoing, including reasonable attorneys' fees.<sup>90</sup>

The court did not treat this clause as a prevailing-party fee clause. It held that the clause applied, but the indemnitee (Bridges) had the burden of proving the reasonableness of his damages under this clause, and could not recover without proof. And, having bargained for specific terms of a contractual indemnity provision, Bridges could not rely on equitable principles to obtain other consequential damages in the form of attorney fees, outside the terms of that indemnity agreement.<sup>91</sup>

The rule in Washington – and in many other jurisdictions as well – limits the recovery of attorney's fees under an

---

<sup>89</sup> *Id.*, n.6. (Emphasis added.)

<sup>90</sup> *Id.* at 100.

<sup>91</sup> *Newport Yacht Basin*, 168 Wn. App. at 107.

indemnity agreement to the defense of the claims indemnified against, and does not even extend the recovery to fees for seeking enforcement of the indemnity agreement, much less prevailing-party attorney's fees.<sup>92</sup> In *Jones*, for example, the indemnity clause required the indemnitor:

To indemnify and save harmless the CONTRACTOR from and against any and all suits, claims, actions, losses, costs, penalties, and damages, of whatsoever kind or nature, including attorney's fees, arising out of, in connection with, or incident to the SUBCONTRACTOR'S performance of this SUBCONTRACT.<sup>93</sup>

Our Supreme Court in *Jones* held that “in the absence of express contractual terms to the contrary,” an indemnitee could not recover attorney's fees incurred in the first-party action between the parties to obtain indemnification.<sup>94</sup>

Likewise, in *Tri-M Erectors*, the indemnity clause in the contract stated:

INDEMNITY. Indemnify and save contractor harmless from all claims, suits and actions (including costs, expenses and reasonable attorneys

---

<sup>92</sup> *Jones v. Strom Constr. Co., Inc.*, 84 Wn.2d 518, 523, 527 P.2d 1115 (1974) (commenting that this is a nearly unanimous rule).

<sup>93</sup> *Jones*, 84 Wn.2d at 521 (emphasis added).

<sup>94</sup> *Id.* at 523.

fees incurred by Contractor or others in defending the same) of any character, nature or description made or brought for or on account of any injury, death or damage (physical or otherwise) allegedly or actually received, suffered or sustained by any person, ... caused by or allegedly caused by or arising from any act or omission of Subcontractor ... in or in any way connected with the performance of this Subcontract ...<sup>95</sup>

The court held that this clause allowed recovery of attorney's fees on the third-party claims of the injured party against the general contractor, Drake, since the accident was "connected with the performance" of the subcontract, and fell within the language of the indemnity provision.<sup>96</sup> But Drake also sought reimbursement of its attorney's fees and costs expended in litigation to establish the applicability of the contractual indemnity. The appellate court held that, under *Jones*,

The contract between Drake and Tri-M failed to expressly indemnify Drake for attorneys' fees and costs expended in an action to establish indemnification. Therefore the trial court did not err in refusing to award Drake attorneys' fees and costs incurred in the instant suit.<sup>97</sup>

---

<sup>95</sup> *Tri-M Erectors, Inc. v. Donald M. Drake Co.*, 27 Wn. App. 529, 532, 618 P.2d 1341 (1980) (emphasis added).

<sup>96</sup> 27 Wn. App. at 534.

<sup>97</sup> *Tri-M Erectors*, 27 Wn. App. at 538.

Accordingly, Washington law as shown in *Newport Yacht Basin, Jones, and Tri-M Erectors* is that the type of indemnification clause in the Contractor Agreement does not authorize recovery of fees to the prevailing party in an action between the parties to the agreement.

Many jurisdictions have held, like Washington, that similar indemnification provisions apply only to third-party claims both because indemnification provision concern third-party claims and because the court should not infer an intent to waive the American Rule absent clear language.<sup>98</sup>

---

<sup>98</sup> See, e.g., *Hooper Associates, Ltd. v. AGS Computers, Inc.*, 74 N.Y.2d 487, 548 N.E.2d 903, 549 N.Y.S.2d 365 (1989) (clause provided indemnity for third-party claims only, prevailing-party fees must be explicit); *Canopy Corp. v. Symantec Corp.*, 395 F.Supp.2d 1103, 1114-15 (D.Utah 2005) (holding the use of the word “defend” in the indemnification provision indicates the parties intent for the provision only to apply to third-party claims); *Colonial Pipeline Co. v. Nashville & E.R.R.*, 253 S.W.3d 616, 619 & 624 (Tenn.Ct.App. 2007) (holding indemnity provision applied only to third-party suits because applying the provision to a dispute between the contracting parties would yield an absurd result); *NevadaCare, Inc. v. Dept. of Human Services*, 783 N.W.2d 459, 471, (Iowa 2010) (use of terms “indemnify” and “hold harmless” indicates intent to protect a party from third-party claims; no intent to shift fees between contracting parties); *PacifiCorp. v. SimplexGrinell, LP*, 256 Or. App. 665, 303 P.3d 949 (2015) (to the same effect).

Because Washington law does not support interpreting an indemnity clause as a prevailing-party clause, the trial court erred as a matter of law by allowing the Cannons attorney fees as part of their settlement. The trial court abused its discretion in finding reasonable a settlement including attorney fees not recoverable.

The trial court's "findings" in paragraph 9 of the findings and conclusions do not change this. The "findings" there, like other findings, are in fact conclusions of law. Contrary to the statements there, it was not "reasonable to include and consider attorney fees and costs in order to induce and effectuate the settlement." The statements that "the contract provided for an award of attorney fees and costs to [the Cannons]" and "it is reasonable for a party to require such expenses to be included in a settlement" and "[t]he court finds that it is reasonable to include attorney fees and costs in the settlement"<sup>99</sup> are legally incorrect conclusions of law.

---

<sup>99</sup> CP 1431.

C. The trial court abused its discretion in finding the settlement reasonable despite evidence of collusion and Cook's inability to pay.

Not only does the inclusion in the settlement of substantial amounts not recoverable show that the settlement was unreasonable as a matter of law, but its collusive nature does as well.

The undisputed evidence before the court showed that Cook had no ability to pay any judgment that might be entered against it.<sup>100</sup> The evidence also showed that Cook was prepared to fight the Cannons on both liability (by showing that the damage was traceable to Howes' uncompacted fill) and damages and that its counsel had estimated its chance of a defense verdict at 50% - 60% and the amount of realistic settlement at \$150,000 to \$350,000.<sup>101</sup> And the evidence showed that Cook, having been given a covenant not to execute – meaning that it would not have to pay the amount of the stipulated judgment whatever it was – suddenly shifted course and stipulated to a judgment for the full amount of the Cannons' claim, including

---

<sup>100</sup> CP 1139.

<sup>101</sup> CP 1056-1064.

amounts not recoverable as a matter of law and without any deduction for any amount of the settlement with Howes.<sup>102</sup>

Nevertheless, the trial court entered “findings” that Western Heritage “did not establish that the ability of defendant Cook to pay was an important factor in the settlement of this case. There was no evidence that the ability to pay indicated that the settlement was unreasonable in light of the other factors and the facts of the case.” The trial court further stated that “[t]here was no evidence or suggestion that the settlement arose from bad faith, collusion, or fraud.”<sup>103</sup>

These ability-to-pay statements are not factual findings; they are conclusions of law. The only proper factual finding on the ability-to-pay factor is that Cook had no ability to pay; that was undisputed. The trial court’s statements about the effect of that inability to pay are determinations of the legal significance of the evidentiary facts and are thus conclusions of law.

The trial court’s statement about collusion is either a legal conclusion (if the trial court is saying that the evidence

---

<sup>102</sup> CP 787-793.

<sup>103</sup> CP 1433.

presented does not qualify as collusion) or a factual finding unsupported by substantial evidence (if the trial court is saying that no evidence of collusion was presented).

Our courts have recognized that a settlement with a covenant not to execute “raises the specter of collusive or fraudulent settlements” making “the limitation on an insurer’s liability for settlement amounts . . . all the more important,”<sup>104</sup> and that “the reasonableness of a settlement with an insured who is not personally liable for a settlement is open to question because the insured will have no incentive to minimize the amount.”<sup>105</sup> Our courts have also recognized that a settlement with a defendant unable to pay strongly indicates unreasonableness.<sup>106</sup>

Here, the evidence was undisputed that:

- Cook had no ability to pay any judgment in this case.

---

<sup>104</sup> *Besel v. Viking Ins. Co.*, 146 Wn.2d 730, 738, 49 P.3d 887 (2002).

<sup>105</sup> *Werlinger v. Warner*, 126 Wn. App. 342, 351, 109 P.3d 22 (2005), *review denied*, 155 Wn.2d 1025 (2005).

<sup>106</sup> *Aspen Grove Owners Assn. v. Park Promenade Apts.*, 842 F. Supp. 2d 1298, 1303 (W. D. Wash. 2012).

- Just before the settlement Cannons offered to settle with defendants for \$550,000.
- Within a few weeks after settling with Howes for \$402,000, Cook settled with the Cannons with a covenant not to execute for \$1.293 million.
- The settlement amount consisted of the full amount of every damage element claimed by the Cannons, including elements totaling over \$800,000 that the law does not permit.

Collusion in the covenant-judgment context “occurs when the insured and the third-party claimant work together to manufacture a cause of action for bad faith against the insurer or to inflate the third-party’s recovery to artificially increase damages flowing from the insurer’s breach.”<sup>107</sup> By working together Cook and the Cannons made the normal adversary relationship in the settlement process vanish. The evidence shows that their actions met the definition of collusion as a matter of law: they worked together to inflate the Cannons’ recovery (which Cook would never have to pay) by artificially increasing the damages to be paid by Western Heritage (by

---

<sup>107</sup> *Safeco Ins. Co. of Am. v. Parks*, 170 Cal. App. 4<sup>th</sup> 992, 88 Cal. Rptr.2d 730, 748 (2009); *Andrade v. Jennings*, 54 Cal. App. 4<sup>th</sup> 307, 62 Cal. Rptr.2d 787 (1997) (substantial evidence established that settling parties crafted the settlement with the specific aim to injure excess insurer).

Cook's dropping of all resistance and agreeing to amounts the Cannons could not have recovered at trial.) These facts equally indicate bad faith.

In the face of these stark facts, the Cannons claimed, without citing any evidence, that "Cook was not disinterested [sic] in the settlement amount."<sup>108</sup> This was true, claimed the Cannons, because of "the damages it would face at trial" together with the additional risks it would face "such as additional expert costs, interest, attorney fees and time."<sup>109</sup> This logic is elusive. Cook's expert costs and attorney fees were borne by Western Heritage, as the record reflects;<sup>110</sup> they were not a risk to Cook. It is not clear what the Cannons mean by "interest." If they mean additional prejudgment interest, it was, as discussed above, not recoverable. And it is difficult to comprehend how Cook was "not disinterested in the settlement amount" when it stipulated to one hundred percent of the "damages it would face at trial," including \$800,000 the Cannons

---

<sup>108</sup> CP 1188.

<sup>109</sup> CP 1188.

<sup>110</sup> CP 1223, 823.

could not recover. The Cannons do not and cannot explain how Cook had any incentive to minimize the amount of settlement, nor can they point to facts suggesting that it in fact did so.

The trial court's legal conclusion that Cook's inability to pay and collusion were not relevant was incorrect as a matter of law.

**D. The trial court abused its discretion in denying Western Heritage discovery focused on the negotiation of the settlement.**

The trial court's erroneous "findings" on collusion also underline how its earlier denial of discovery was also an abuse of discretion. Well in advance of the reasonableness hearing Western Heritage moved for discovery tightly focused on the final negotiation of the settlement. Specifically Western Heritage asked to depose Michael Cook (the President of Cook Custom Homes), Cook's defense counsel, and Cannons' counsel John Black. This discovery targeted the bad-faith and collusion element of the reasonableness factors. Western Heritage explained that this discovery was necessary to fill the information gap between Cannons' final settlement offer of

\$553,000 to both defendants and the settlement agreement for \$1.293 million.<sup>111</sup>

The Cannons claimed that this discovery was “redundant and unnecessary,” was “a fishing expedition on unfounded suspicions of fraud or collusion” because the settlement was “completely transparent” and “indications of bad faith, collusion and fraud are entirely absent.” They claimed that the discovery could yield nothing because it sought privileged information.<sup>112</sup>

The trial court denied Western Heritage’s motion.<sup>113</sup> That ruling is subject to review for abuse of discretion.<sup>114</sup>

CR 26 generally allows discovery of non-privileged information. Indeed, our Supreme Court has stated that the “right to discovery is an integral part of the right to access to courts embedded in our [state] constitution.”<sup>115</sup> Relevant, timely discovery should therefore be allowed as a matter of right.

---

<sup>111</sup> CP 813-820; 1015-1027; 1028-1030.

<sup>112</sup> CP 821, 827, 828, 829.

<sup>113</sup> CP 1038-1030; RP (6/21/2013) 13-14.

<sup>114</sup> *In Re Det. of Halgren*, 156 Wn.2d 795, 802, 132 P.3d 714 (2006).

<sup>115</sup> *Cedell v. Farmers Ins. Co. of Washington*, 176 Wn.2d 686, 695, 295 P.3d 239 (2013).

Once the parties had entered into their settlement agreement and sought a reasonableness determination, the case entered a new phase — one concerned with the settlement process. While the discovery undertaken before the settlement was relevant to some of the reasonableness-hearing factors, it did not address the settlement itself and the possible collusion between the parties in negotiating the settlement during the period between the Cannons' last settlement demand (\$550,000) and the \$1.293 million settlement. That was the missing discovery that Western Heritage sought with its focused discovery requests. And that discovery was directly relevant to the issues on the reasonableness hearing.

Both the Cannons' response and the trial court's ruling failed to address the point of the discovery. The Cannons conclusorily claimed that no indications of bad faith, collusion or fraud existed when in fact (1) the settlement amount tripled from the Cannons' last demand, (2) about two-thirds of the settlement amount consisted of amounts not recoverable as a matter of law, and (3) Cook had no incentive to minimize the settlement amount because of the covenant not to execute. And

they insisted that the discovery sought privileged information when in fact the discovery sought communications between the parties, which were plainly not privileged.

The trial court's reasoning likewise failed to focus on the relevant issues. In ruling, the court said that Mr. Cannon's illness was a "key aspect" leading to the settlement. That was irrelevant. The court was "troubled" by depositions of counsel, but never addressed that the discovery sought non-privileged material from the settling lawyers. Furthermore, the court did not address discovery from Mr. Cook. The court stated that it was "not a new case" and had "a lot of expert involvement." But the court did not address that the need for the discovery of the settlement arose only after the settlement.<sup>116</sup> Reasoning that does not address the issue before the court is untenable. The court abused its discretion in denying the discovery.

The prejudice from the denial of the discovery became apparent at the reasonableness hearing. The Cannons' briefing made assertions without evidentiary support on the very issues to be discovered. They insisted that Cook was "not disinterested"

---

<sup>116</sup> RP (6/21/2013) 13-14.

in the settlement amount (how would one know that without discovery from Mr. Cook about the settlement?). They conclusorily claimed that there was no evidence of fraud and collusion (how would one know that without discovery on that very point?). And, as the trial court findings show, the trial court found – with no explanation – that there was no evidence of bad faith, fraud or collusion.

The plain fact is this: the law requires Western Heritage to show fraud or collusion but the trial court said Western Heritage may not have discovery to obtain evidence in support of collusion. At the same time it faulted Western Heritage for failing to produce evidence that it would not let Western Heritage discover.

The trial court's denial of discovery was an abuse of discretion. This court should reverse.

## V. Conclusion

This settlement, the bulk of which consists of amounts not recoverable, is unreasonable as a matter of law and collusive as a matter of law. This court should reverse the trial court's order finding the settlement reasonable and remand to the trial court

court with directions to find the settlement unreasonable and collusive, and to conduct a further reasonableness determination, provided that the total value of a reasonable settlement amount cannot include unrecoverable damages. In the alternative, if the court does not find the settlement collusive as a matter of law, the court should reverse the trial court's denial of discovery and remand for discovery on collusion.

The court should award Western Heritage its costs.

Dated 22 January 2014



---

Mark Thorsrud, WSBA #7951  
Russell C. Love, WSBA #8941  
Thorsrud Cane & Paulich  
Attorneys for Appellant/ Intervenor  
Western Heritage Ins. Co.