

No. 34540-8-III

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

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COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON

EPIC,

Appellant,

v.

CLIFTONLARSONALLEN,

Respondent.

APPELLANT'S REPLY BRIEF

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I. Reply to CLA's Introduction

Respondent CliftonLarsonAllen ("CLA") asserts that appellant EPIC knew its Chief Financial Officer ("CFO") was violating Federal regulations, ignoring that the CFO did not know he was doing anything improper. CP 202-3. CLA does not explain how EPIC was supposed to know what its CFO was doing was improper when the CFO did not know.

CLA points out the passage of time between when CLA issued its audits and the commencement of the action, ignoring that the questions before the court in this appeal are (1) whether it was reasonable for the two-year period within the limitations clause to commence upon delivery of the audit (to determine whether the contractual limitations clause was enforceable), and if not, (2) when EPIC's cause of action against CLA accrued, for the purpose of applying the discovery rule under the statute of limitations?

CLA then asserts that the two-year limitations period in the contract was not "ambiguous." Ambiguity is not the issue. The issue is that the limitations clause containing the two-year limitations period was unreasonable, as it expired before EPIC had a reasonable opportunity to determine whether CLA had done anything that would be the basis of a claim by EPIC.

II. Reply to CLA's Counterstatement of the Case

A. Facts

CLA's counterstatement overlooks some key facts. The contractual limitations clause in the engagement letters was not conspicuous; from 2006-2009, it was buried in the text of the letters, without any bolding or enlarged typeface. CP 38, 44, 52, and 57. For the 2010 audit, the heading "Time Limitation" was bolded, just as all other headings were bolded. CP 65-71.

In attempting to justify the commencement of the two-year limitations period prior to EPIC being aware that CLA did anything wrong, CLA does not include any reason why extending the time for EPIC to commence an action prejudices CLA's defense. CLA merely recites the clause's language stating that passage of time would make the defense more difficult, but does not explain how the mere passage of time would do so. CLA does not explain why it could not keep records longer.

CLA ignores that there was no notice in its 2011 audit report to EPIC that CLA may have erred by not noting errors by EPIC's CFO in CLA's 2007-2010 audit reports. EPIC's claims in this action are that CLA erred by not noting the CFO's errors earlier, depriving EPIC of the opportunity to stop and correct the errors prior to HHS discovering them.

While HHS notified EPIC in February 2013 that it was seeking to have EPIC repay grant funds, EPIC was not aware until October 2013 that it might have a claim against CLA for that loss. EPIC commenced this action in December 2015, less than three years after incurring damage and later learning CLA may be responsible.

B. Procedural History

EPIC does not dispute CLA's procedural history.

III. Reply to CLA's Standard of Review

EPIC agrees that this court applies a *de novo* standard of review, both to the granting of a CR 12 motion and to the granting of a CR 56 motion, as well as the trial court's conversion of the CR 12 motion to a CR 56 motion, precluding the granting of the CR 12 motion.

IV. Reply to CLA's Summary

CLA mischaracterizes the issue regarding the contractual limitations clause by focusing on the two-year limitations period within the clause, not the entire clause, which provides for the period to commence and expire before EPIC had an opportunity to determine if may have a claim against CLA. CLA then simply asserts the limitations clause is enforceable, overlooking the predicate question of whether the clause is reasonable.

V. Reply to CLA's Argument

- A. CLA ignores that EPIC is challenging the unreasonableness of the date the 2-year limitations period commences.
 - 1. CLA provides no authority or reasons why the limitations period should commence when it does.
 - a. Only reasonable contractual limitations clauses are enforceable.

CLA asserts the contractual limitations clauses are enforceable, citing several Washington decisions. CLA ignores that in each of those decisions, the clauses were enforceable only *after* they were determined to be reasonable. The reasonableness of the limitations clause here is at issue.

- b. EPIC is not challenging the two-year length of the limitations period in the CLA contractual limitations clause.

CLA points out that the two-year length of the limitations period is not inherently unreasonable, ignoring that EPIC is not challenging the two-year length, but when it commences.

- c. One limitations clauses with reasonable commencement dates are enforceable.

CLA cites *Washington State Major League Baseball Stadium Public Facilities Dist. v. Huber, Hunt & Nichols-Kiewit Const. Co.*, 176 Wn.2d 502, 296 P.3d 821 (2013), to support parties' right to agree on a commencement date for the limitations period. There, the issue was

complicated, involving arguments about statutes of repose for construction claims and public policy, but the court basically held that the parties could define the accrual date, without overruling the requirement that the contractual limitations period be reasonable to be enforceable. 176 Wn.2d at 509-15.

CLA also cites *In re Park West Galleries Inc., Mktg. Sales Litig.*, 732 F.Supp.2d 1171 (W.D. Wash. 2010), which approved the commencement date being the date invoices were submitted. The court noted that given the nature of the transaction, the commencement date was reasonable, as it provided plaintiffs at least seven months to inspect the product covered by the invoice to determine whether it was satisfactory. 732 F.Supp.2d at 1175.

While CLA cites *Adler v. Fred Lind Manor*, 153 Wn.2d 331, 103 P.3d 773 (2004), for the proposition that parties are bound by the terms of their contract, that does not contradict or supplant other authority cited by CLA that contractual limitations clauses are only enforced when they are reasonable.

CLA simply asserts the limitations clause here is reasonable. CLA also assumes that EPIC knew that what its CFO was doing with grant funds was improper (when the CFO was unaware it was improper). CLA then assumes EPIC knew that CLA was at fault as soon as HHS notified

EPIC that EPIC had mismanaged grant funds. EPIC's claim against CLA is based on CLA's failure to notify EPIC earlier, before HHS discovered the mismanagement and EPIC suffered damage.

2. Only reasonable limitations clauses are enforced.

CLA again points out that the limitations clause is unambiguous, ignoring that clarity is not the issue.

a. The trial court's determination of when EPIC had knowledge of its claim is irrelevant.

CLA points out what the trial court determined, based upon its review of the declarations submitted. With *de novo* review, the trial court's determinations are irrelevant.

CLA contends EPIC is imputed with whatever knowledge its CFO had regarding the CFO's wrongdoing, ignoring that EPIC's CFO had no knowledge of his own wrongdoing. He believed he was not doing anything improper. CLA provides no authority that a principal (EPIC) is imputed to have greater knowledge than its agent (EPIC's CFO). There is no basis to impute to EPIC knowledge that it was mismanaging grant funds, and further impute to EPIC knowledge that CLA breached any duty to EPIC by failing to notify EPIC of its CFO's mismanagement.

CLA sets forth what the trial court concluded, ignoring its own concession that this court reviews the issues *de novo*, giving no deference to the trial court, so what it decided is irrelevant.

CLA asserts it was proper for the trial court to consider CLA's supporting declarations, to which EPIC agrees, but that means the CR 12 motion was converted to a CR 56 motion, so any relief under CR 12 would be improper.

- b. A "discovery rule" cannot be grafted onto the limitations clause to make it reasonable.

CLA argues EPIC had until June 2015 to assert claims based on the 2006-2009 audits, as the limitations period in those audit letters did not commence until EPIC stopped hiring CLA to perform audits.

Hypothetically, if EPIC continued to hire CLA to perform audits until 2025, EPIC had until 2027 to assert a claim against CLA arising out of the 2006-2009 audits.

This hypothetical situation demonstrates that CLA has no good reason for why the two-year limitations period in the 2010 audit needed to commence upon delivery of the audit, which could lead to the limitations period expiring before EPIC had an opportunity to realize it had a claim against CLA and to commence an action. There is no credible basis for the reason stated in the audit letter for the commencement of the

limitations period being prior to EPIC having reason to know it had a claim, which is that passage of time would make a defense difficult.

If CLA willingly contracted entered into contracts that required it to be prepared to be sued and defend itself decades after delivering its audit, there is no reason why it needed the limitations period of the 2010 audit to commence upon delivery, such that it could expire before CLA's clients, such as EPIC, had an opportunity to determine they had a claim and commence litigation. It was not reasonable to commence the two-year limitations period upon delivery.

CLA goes on to assert that giving EPIC until March 2013 meant "EPIC had plenty of time" to assert its claim arising out of the 2010 audit, due to CLA's report in September 2012 showing the misuse of grant funds in 2009 and 2010. CLA ignores that EPIC's knowledge of the misuse of grant funds is not knowledge that (1) CLA should have pointed out earlier that EPIC's CFO was misusing grant funds, or (2) EPIC would be damaged by such misuse.

EPIC did not learn about its damages from the misuse of grant funds until at least February 2013 when HHS provided preliminary notice that EPIC would be required to repay grant funds, with the exact amount not determined until August 2013. Applying CLA's March 2013 deadline, EPIC had at most a month to investigate to determine if CLA had done

something wrong that made it legally liable for the damage EPIC learned about in February 2013, and retain counsel to commence an action. That is not a reasonable limitations period.

- c. EPIC is not seeking to extend the limitations period in the contract.

CLA criticizes the time EPIC took in hiring its forensic accountant and determining its claim. EPIC's conduct may be relevant to the application of the discovery rule under the statute of limitations, but has no bearing on whether the contractual limitations clause is reasonable and enforceable.

CLA asserts that even if the court postpones the commencement date of the 2-year limitations period in the contractual limitations clause, EPIC's claim is still time-barred under that clause. That may be true, but EPIC is not seeking to extend the commencement date. As CLA asserts, the clause is not ambiguous. There is no basis for construing the commencement date in the clause as anything other than what it states.

The question for this court is whether the unambiguous commencement date renders the clause unreasonable, which would make it unenforceable. EPIC is not asking the court to modify the clause. If the commencement date of the limitations period renders the clause

unreasonable, the entire clause is unenforceable. The court is left to apply the statute of limitations.

3. The reasonableness of the limitations clause depends upon when it commences, not its duration.

CLA correctly does the math to determine that *if* the limitations clauses in the audit letters are enforceable, EPIC's claims are time-barred by the clauses. The issue is whether the clauses are enforceable, and if not, whether EPIC's claims are time-barred under applicable statutes of limitations.

- B. A court can only sever, not reform, an unreasonable limitations clause.

CLA expressly asks this court, if necessary, to sever the commencement date out of the contractual limitations clause, citing authority on severing unenforceable clauses from contracts. CLA ignores that the authorities on which it relies only provide for severing entire contractual provisions, not partially severing and then adding, which results in reformation of the contractual provision.

“Reformation is an equitable remedy which permits the court to correct errors to render an instrument expressive of the real intentions of the parties.” *J.J. Welcome & Sons Constr. Co. v. State*, 6 Wn.App. 985, 988, 497 P.2d 953 (1972). Reformation has no application here, as there

is no evidence the parties intended the two-year limitations clause to commence upon accrual or discovery of EPIC's claim.

CLA's own authority undercuts its argument. In *Adler*, 153 Wn.2d at 358-9, the court severed unconscionable attorney fees and limitations provisions in their entirety, not portions of them. The commencement date of the limitations period is not a term or provision of the audit letter; the commencement date is integral to the limitations provision.

In *In re Park West Galleries Inc., Mktg. Sales Litig.*, *supra*, the court rejected the plaintiffs' request to graft a discovery rule onto the limitations clause. 732 F.Supp.2d at 1175. This is the very argument CLA makes here.

The discovery rule is a common law doctrine tolling the statute of limitations until the cause of action "accrues." *Sabey v. Howard Johnson & Co.*, 101 Wn.App. 575, 592-3, 5 P.3d 730 (2000). CLA's contractual limitations clause states nothing about when claims against CLA "accrue" to mark the date for commencing the two-year limitations period. The clause states the two-year period commences upon delivery, whether or not a cause of action has accrued or not. This court has no authority to modify the limitations clause by tacking on the discovery rule to be part of the clause.

C. When EPIC should have “discovered” its claim is a factual question.

1. If EPIC discovered the basis of its malpractice claim after December 2012, the action is within the three-year statute of limitations for tort claims.

Applying the three-year statute of limitations for malpractice claims, and the discovery rule, EPIC’s claims are not within the statute of limitations if it should not have reasonably discovered its claims against EPIC prior to December 2012. Given HHS’s preliminary notice of repayment of grant funds was not until February 2013, that is the earliest date when EPIC should have “discovered” its claim against CLA.

2. EPIC’s contract claim is within the six-year statute of limitations for breach of written contract claims.

CLA acknowledges it is potentially liable for breach of contract if EPIC alleges CLA breached a specific contractual term, rather than just a general duty. EPIC identified a specific duty in CLA’s audit letter, to determine compliance with OMB Circular A-133, part of federal grant funding rules, that CLA allegedly violated. This is sufficient to support a breach of contract claim, subject to a six-year statute of limitations.

D. *In pari delicto* doctrine has no application where there is no evidence of intentional wrongdoing by EPIC.

CLA’s *in pari delicto* defense does not apply to EPIC’s contract or tort claims, as there is no evidence EPIC engaged in intentional

wrongdoing. In the breach of contract context, *in pari delicto* applies to preclude enforcement of an illegal contract. *Goldberg v. Sanglier*, 96 Wn.2d 874, 879, 639 P.2d 1347, 647 P.2d 489 (1982). In the malpractice context, *in pari delicto* prevents a claimant who engaged in intentional or criminal wrongdoing from recovering for its damages. *Kirschner v. KPMG LLP*, 938 N.E.2d 941 (N.Y. 2010).

EPIC did not allege or argue that EPIC's CFO or any other person at EPIC engaged in criminal or fraudulent conduct in its handling of grant funds, or that any EPIC agent committed an intentional tort or criminal conduct. CLA describes EPIC's mishandling of federal funds with the generic term "misconduct." There is no sufficiently wrongful conduct by anyone at EPIC that bars recovery in contract or tort from CLA. EPIC's CFO was not aware he was doing anything improper.

CLA provides no Washington authority applying the *in pari delicto* defense to deny a client's recovery against an accountant or any other professional. The Washington authority cited by CLA only recognizes the doctrine exists to deny enforcement of illegal contracts between equally culpable parties. That has no application here.

Instead, CLA relies primarily on *Kirschner v. KPMG LLP*, 938 N.E.2d 941 (N.Y. 2010), a fraud case whose only similarity to the present action is the businesses of the parties: the defendant was an accounting

firm and the plaintiff was its client; the conduct and issues involved were quite different. There, the plaintiff was a firm whose senior management engaged in intentional, arguably criminal, fraud, which was imputed to the plaintiff under agency principles. There was no dispute that the agents' intentional misconduct warranted application of the *in pari delicto* defense; the only issue in dispute was whether the agents' intentional misconduct could be imputed to the corporation, or instead, the agents had abandoned the interests of the corporation such that the "adverse interest" exception to imputation applied. 938 N.E.2d at 949.

Decisions applying *Kirschner* show that the *in pari delicto* doctrine was used to deny the plaintiff a recovery there only because the plaintiff engaged in intentional fraud. *Rosenbach v. Diversified Group, Inc.*, 85 A.D.3d 569 (Supr. Ct. N.Y. 2011), discussed *Kirschner*, explaining that *in pari delicto* applied as a defense based on the plaintiff's "intentional conduct." 85 A.D.3d at 570. *Rosenbach* noted that *in pari delicto* bars claims when a party seeks recovery for its "own intentional wrongdoing" from a party of equal or lesser fault. *Id.* Application of the doctrine "requires immoral or unconscionable conduct." *Id.*

The authorities cited by CLA do not support applying the *in pari delicto* defense to bar a plaintiff's claim when there is no allegation or evidence that the plaintiff engaged in any intentional misconduct. CLA

does not even attempt to provide a rationale for extending the doctrine to a case where there is no intentional misconduct.

VI. Conclusion

CLA has not shown that it was reasonable to require EPIC to commence its action within two years of the delivery of the 2010 audit, which makes the contractual limitations clause unreasonable and unenforceable. Applying either the 3-year statute of limitations and the discovery rule for malpractice claims, or the 6-year statute of limitations for written contracts, EPIC's action here is not time barred. EPIC asks that this court reverse the trial court's granting of a dismissal under CR 12 and summary judgment under CR 56.

DATED this 4th day of January, 2017.

HULTMAN LAW OFFICE

By: /s/ [Signature]
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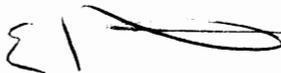
CERTIFICATE OF SERVICE

I certify that a copy of the foregoing document has been served by email, on the 4th day of January, 2017, to:

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