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

COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

EPIC,

Appellant,

v.

CLIFTONLARSONALLEN,

Respondent.

APPELLANT'S OPENING BRIEF

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A. Introduction

This appeal addresses the issue of whether a client's claims arising out of professional malpractice may be time-barred, as a matter of law without a trial, based on either (1) a contractual limitation period that required an action to be commenced prior to the time the client realized it had been damaged, or (2) the statute of limitations commencing to run prior to the client "discovering" the factual basis for its claim. It also addresses the issue of whether a professional malpractice claim may be asserted as a breach of contract.

Here, EPIC, a non-profit that receives grant funding to pay for its operations, hired CliftonLarsonAllen ("CLA")¹ to audit its financial practices to assure compliance with grant requirements. EPIC was not in compliance, which CLA failed to uncover, depriving EPIC of an opportunity to correct its non-compliance prior to it being uncovered by the grant-funding agency, which resulted in EPIC losing grant funding.

The trial court granted CLA's motions under CR 12(b)(6) and CR 56 to dismiss EPIC's claims as time-barred, based on a 2-year contractual limitations period in engagement letters. Such a short limitation period, with no tolling until EPIC accrued any damages, was not

¹ EPIC retained LeMaster Daniels PLLC, a firm acquired by CLA.

enforceable, as it was unreasonable. The underlying statute of limitations, tolled by the discovery rule, did not bar EPIC's claims.

B. Assignments of Error

Assignments of Error

1. The trial court erred when it decided CLA's CR 12(b)(6) motion while considering evidence outside the pleadings.

2. The trial court erred when it granted CLA's CR 12(b)(6) motion to dismiss EPIC's claims based on enforcing a 2-year limitations period in a contract to bar EPIC's claims.

3. The trial court erred when it granted CLA's CR 56 summary judgment motion in favor of CLA based on enforcing a 2-year limitations period in a contract to bar EPIC's claims.

Issues Pertaining to Assignments of Error

1. May the trial court decide a CR 12(b)(6) motion when it considers documents not referenced in the pleadings? (Assignment of Error No. 1)

2. Is a 2-year limitations period in a contract enforceable to bar claims if the claimant did not suffer any actual damage within two years? (Assignments of Error Nos. 2 and 3)

3. May a plaintiff alleging professional malpractice assert a breach of contract claim if the malpractice involves violation of a specific contractual provision? (Assignments of Error Nos. 2 and 3)

C. Statement of the Case

1. EPIC retained CLA to audit its financial practices to assure compliance with grant funding requirements in years 2007-2011.

EPIC is a non-profit corporation that received Head Start funding from the U.S. Department of Health and Human Services (“HHS”). CP 8-9. The grant funding contained restrictions on how it was used. CP 9. From 2007-2011, EPIC improperly used grant funding for one time-period to pay expenses not incurred during that time-period. *Id.*

EPIC retained CLA to perform auditing services. *Id.* CLA’s audits from 2007-2010 failed to uncover the mismatching of grant funding and expenses during those years. *Id.*

In CLA’s engagement letters for the years 2009-2010, there were provisions expressly addressing CLA’s obligation to assure that EPIC was properly administering federal grant funds, in accordance with OMB Circular 133 A-133. CP 54, 68. CLA’s audit for 2011 noted issues with EPIC’s handling of federal funds in 2011. CP 118.

2. HHS discovered financial mismanagement of grant funds by EPIC in 2011, requiring EPIC to return grant funds and decline to seek future grant funds for two years.

In February 2013, HHS notified EPIC that due to the failure of EPIC to comply with grant funding rules in 2011, EPIC was required to refund \$1,146,039 of 2011 grant funds. CP 9. EPIC was able to get that later reduced to \$303,287. *Id.*

In April 2013, to protect EPIC's future eligibility for Head Start funds from HHS, EPIC decided to relinquish federal funds effective immediately. *Id.* The reason for doing this was, if EPIC appealed the decision to discontinue our funding and lost, EPIC would no longer be eligible to administer the program. *Id.* EPIC, in order remain eligible for future grants, relinquished grants of \$7,514,963 for 2013 and \$12,392,427 for 2014. *Id.*

3. EPIC diligently attempted to determine whether CLA had breached any duties in performing its audits in years 2007-2010.

When EPIC's senior management found out that EPIC's CFO had been violating grant-funding rules by using grant funds from one time-period to pay expenses incurred in a different time-period, they put a stop to it. CP 146. In February 2012 the CFO was terminated due to his apparent inability to properly manage Head Start funds and was replaced in April of 2012 with the current CFO. *Id.* If CLA had notified EPIC in

audits of years 2007-2010 of the mismatching of funds, EPIC could have corrected the mistakes prior to 2011, avoiding any loss of grant funding based on the mismatching in 2011. *Id.* CLA delivered the 2010 audit to EPIC in March 2011. CP 95.

In August 2013, after HHS reduced the amount of 2011 funding EPIC would have to repay, EPIC began focusing on (1) how the mismatching occurred, (2) how long it went on, and (3) whether CLA could have uncovered it sooner, alerting EPIC prior to HHS finding out, so EPIC could correct the problem without having to either repay grant funds to HHS or decline to seek grant funds in 2013. CP 146.

In September 2013, EPIC retained Tiffany Couch, a forensic accountant, to investigate CLA's work. *Id.* She did not provide a report to EPIC until June 2015. *Id.* In that report, she stated that CLA's working papers would help her understand why CLA had not uncovered the mismatching of grant funds, which began in 2007, prior to HHS doing so. *Id.* EPIC first attempted to obtain CLA's working papers through the forensic accountant in January 2015. Frustrated by CLA's refusal to turn over its working papers, EPIC decided to initiate this action in December 2015. *Id.*

Couch found that there were consistent errors in handling federal grant funds in years 2007-2010 (and 2011) that the auditors should have detected. CP 149. These errors began in the 4th quarter of 2007 and consisted of the fact that the actual drawdowns of federal funds did not match actual expenditures. *Id.* What's more, the audited reports of expenditures of federal dollars did not match the actual expenditures per EPIC's general ledger. *Id.* The failure to identify these errors likely breached the standard of care for auditors such as LeMaster Daniels. *Id.*

While Couch was able to identify the discrepancies between the audits, the federal reports, and the general ledger, she was unable to identify a motive or a personal benefit to EPIC's former controller. *Id.* It appears that poor bookkeeping and grant accounting methods contributed to these errors. *Id.*

The errors in handling Head Start-related funds in 2011 (comparable to errors going back to 2007) were the basis for Head Start's decision to require EPIC to repay those funds for 2011. *Id.* Those 2011 errors and Head Start's determination of repayment, were also the basis for EPIC's decision to not request Head Start funding in 2013 and 2014. *Id.*

Given the fact that HHS did not notify EPIC of the mishandling of Head Start Funds until February 2013, EPIC could not have known the

damages they suffered related to LeMaster Daniels' failure to disclose the errors. CP 150.

Couch opined that the two-year limitation in CLA engagement letters for bringing a claim is unreasonably short, as many errors by auditors will not become apparent to the principal within that two-year period. *Id.*

4. EPIC commenced this action in December 2015.

EPIC commenced this action in December 2015. CP 8. It asserted claims for legal malpractice/professional negligence, negligent misrepresentation, and breach of contract, all arising out of CLA's audits of EPIC in years 2007-2010. CP 8-11.

5. The trial court dismissed under CR 12(b)(6) and in the alternative, granted summary judgment under CR 56, both based on the 2-year limitation in engagement letters.

CLA moved to dismiss under CR 12(b)(6) and for judgment under CR 56 on the basis that EPIC's claims were time-barred. CP 12. CLA relied upon CLA's engagement letters from 2007-2011 that contained language purporting to require any claims against CLA arising out of its work to be commenced within two years of the delivery of the final audit for that year. *Id.*

The trial court granted CLA's motions based on the 2-year limitations period. CP 178. This appeal timely followed. CP 184.

D. Argument

1. This Court reviews the trial court decisions *de novo*.

The trial court decisions at issue were on issues of law that are reviewed *de novo*. The appellate court reviews *de novo* issues of law decided by the trial court. *Roger Crane & Ass. v. Felice*, 74 Wn.App. 769, 773, 875 P.2d 705 (1994).

Here, CLA first asked the trial court to dismiss all of EPIC's claims under CR 12(b)(6), which the trial court did. In the alternative, the trial court granted CLA's CR 56 summary judgment motion to dismiss EPIC's complaint as being time-barred under a 2-year limitations period in engagement letters. The trial court granted both dismissal and summary judgment, which are subject to *de novo* review.

The standards for summary judgment are that the moving defendant has the burden of showing there are no issues of material fact; only then does the burden shift to the nonmoving plaintiff to produce evidence supporting its claim. *Fischer-McReynolds v. Quasim*, 101 Wn.App. 801, 808, 6 P.3d 30 (2000). The court must accept the truth of the nonmoving party's evidence and draw all favorable reasonable inferences for that party. *Queen City Farms, Inc. v. Central Nat'l Ins. Co. of Omaha*, 126 Wn.2d 50, 98, 882 P.2d 703, 891 P.2d 718 (1994). The court may grant judgment only where there is no competent evidence or

reasonable inference that would sustain a verdict for the nonmoving party.

Id.

Given CLA sought dismissal and/or summary judgment based on an affirmative defense that EPIC's claims were time-barred, for purposes of the motions before the trial court, EPIC asserted valid claims. An affirmative defense does not controvert a plaintiff's claim. *Shinn Irr. Equip. v. Marchand*, 1 Wn.App. 428, 430-1, 462 P.2d 571 (1969).

2. The CR 12(b)(6) motion could not be granted when the trial court considered evidence outside the pleadings.

CLA characterized its motion as one under CR 12(b)(6), but then asked the court to consider evidence outside the pleadings, which the court did. This converted the CR 12(b)(6) motion into a summary judgment motion under CR 56, precluding relief under CR 12(b)(6). When a court considers evidence outside the pleadings, the CR 12(b)(6) motion is converted to a summary judgment motion, with all the applicable rules under CR 56. CR 12(b).

CLA argued that the engagement letters could be considered without converting the CR 12(b)(6) motion into a CR 56 motion. It cited authority that "[d]ocuments whose contents are alleged in a complaint but not attached may be considered when ruling on a CR 12(b)(6) motion." *Jackson v. Quality Loan Serv. Corp.*, 186 Wn.App. 838, 844, 347 P.3d

487 (2015). That authority has no application here, as the content of the engagement letters and audits were not alleged in EPIC's pleading. EPIC's pleading expressly references only one document: a letter dated February 8, 2013.

The trial court erred in ruling on CLA's CR 12(b)(6) motion while considering the engagement letters that were outside the pleadings.

3. The 2-year limitations period in engagement letters was not enforceable, as it was not reasonable.

CLA sought to bar EPIC's claims as untimely by applying a 2-year limitation period contained in engagement letters. Such a 2-year limitations period was unreasonable, rendering it unenforceable. Courts will not enforce a contractual limitation period that is unreasonable. *Yakima Asphalt & Paving Co. v. Dept. of Transportation*, 45 Wn.App. 663, 666, 726 P.2d 1021 (1986).

Here, the unreasonableness of the two-year limitation period in the engagement letters is not the length, but when it commences. The period commences upon delivery of the audit, rather than when EPIC was damaged such that it would have grounds to bring an action for malpractice. The damage necessary for a claim to accrue must be "actual" and "appreciable," not the "mere danger of future harm." *Haslund v. Seattle*, 86 Wn.2d 607, 619-20, 547 P.2d 1221 (1976).

The crucial date for the enforceability of the 2-year limitations period is March 2013, two years from the date of the delivery of the 2010 audit, the last audit where CLA failed to disclose grant mismanagement by EPIC. The question is whether EPIC had a reasonable opportunity to commence an action prior to March 2013 arising out of that audit.

EPIC did not have a reasonable opportunity to ascertain that CLA's 2007-2010 audits were deficient, and that EPIC had been damaged by those audits, until HHS issued its disallowance in August 2013. It was not reasonable to require EPIC to commence a malpractice action prior to EPIC realizing it had been damaged.

Even if EPIC had notice that it was damaged by HHS' preliminary notice in February 2013, the 2-year limitations period is not sufficient. EPIC would have only a month at most to investigate, obtain an expert's opinion, and ascertain that EPIC had a claim against CLA, consult with and retain counsel, and commence an action arising out of the 2010 audit.

In addition, that date is more than two years after delivery of the 2007-2009 audits, so the two-year contractual limitations period in those audits, if enforced, would have required EPIC to initiate an action arising out of those audits prior to EPIC being aware of any problem.

CLA did not provide a reason for why a two-year contractual limitations period, commencing upon delivery of the audit rather than

accrual of the cause of action, was necessary for auditors or reasonable for its business. When courts enforce a shorter limitations period than the applicable statute of limitations, the court explained why it was reasonable in those circumstances. What made it reasonable is the plaintiff still had a reasonable amount of time to ascertain that it had a claim before the shorter limitations period expired, and the plaintiff had no reason for not commencing the action in time.

In *Syrett v. Reisner McEwin & Assocs.*, 107 Wn.App. 524, 24 P.3d 1070 (2001), primarily relied upon by CLA in the trial court, the court noted that the plaintiff provided “no explanation why” the contractual limitation period “should not be viewed as reasonable.” In contrast, EPIC provides reasons. EPIC was not damaged by CLA’s auditing errors until HHS took action against EPIC, which did not occur until more than two years after CLA delivered the audits for the years 2007-2010.

Syrett cited with approval *Sheard v. United States Fid. & Guaranty Co.*, 58 Wn. 29, 107 P. 1024 (1910), where the Washington Supreme Court noted that a contractual limitation period that required a plaintiff to commence the action prior to being able to ascertain its “pecuniary loss” was “unreasonable.” 58 Wn. at 35.

Syrett also cited *Nicodemus v. Milwaukee Mutual Ins. Co.*, 612 N.W.2d 785 (Iowa 2010), striking down a two-year contractual limitations

period as unreasonable, as it did not provide the plaintiff sufficient time to ascertain and investigate the claim and prepare for the controversy. It is *per se* unreasonable to require a plaintiff to commence an action prior to the date when “the loss or damage is capable of being ascertained.” 612 N.W.2d at 787. A limitations period that in essence abrogates the right of recovery is unenforceable. *Id.* at 788.

Other times when a shorter contractual limitations period was enforced, the limitations period commenced after the plaintiff had suffered some loss or damage, not mere delivery of a document. In *Wothers v. Farmers Ins. Co.*, 101 Wn.App. 75, 5 P.3d 719 (2000), the contractual limitations period commenced upon the date of the plaintiff’s loss. 101 Wn.App. at 79. In *Yakima Asphalt, supra*, the plaintiff would be aware of his damage prior to the limitations period commencing. 45 Wn.App. at 766. EPIC had not suffered any loss at the time CLA delivered its audits.

The two-year limitations period, which expired before EPIC sustained any “actual damage” such that the claim accrued, was unreasonable here. The trial court erred by applying it to bar EPIC’s claims.

Without the 2-year limitations period from the engagement letters, EPIC’s claims were subject to the statute of limitations. This court can affirm the trial court’s ruling on a different basis than that relied upon by

the trial court. *Gross v. City of Lynnwood*, 90 Wn.2d 395, 401, 583 P.2d 1197 (1978). Therefore, the next sections address why EPIC's claims are not barred by the statute of limitations.

4. There are issues of fact regarding whether EPIC should have "discovered" the basis for its claims against CLA more than three years prior to commencement of the action.

There are factual issues as to whether EPIC, exercising proper diligence, should have discovered the factual basis for its negligence and misrepresentation claims more than three years prior to commencement of the action, precluding summary judgment regarding the 3-year statute of limitations of RCW 4.16.080. Whether a plaintiff has exercised due diligence under the discovery rule is a question of fact. *Mayer v. City of Seattle*, 102 Wn.App. 66, 76, 10 P.3d 408 (2000). The issue of whether a plaintiff has suffered actual damages triggering the statute of limitations "can be decided as a matter of law if reasonable minds could reach but one conclusion." *Hudson v. Condon*, 101 Wn.App. 866, 875, 6 P.3d 615 (2000). Because the statute of limitations is an affirmative defense, the burden of proof is on the defendant. *Mayer*, 102 Wn.App. at 76.

The discovery rule tolls 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). The discovery rule applies to malpractice actions

against accountants. *Hunter v. Knight, Vale and Gregory*, 18 Wn.App. 640, 644, 571 P.2d 212 (1977).

Here, EPIC commenced the action in December 2015, so the crucial date when applying the “discovery rule” to the 3-year statute of limitations is December 2012. In order for EPIC’s claims to be time-barred, it must be undisputed that EPIC should have discovered the factual basis of its claim prior to December 2012.

HHS’ formal notice that EPIC was required to return grant funds was in February 2013, with EPIC commencing this action within three years. Prior to that, EPIC was aware there was a problem between it and HHS, but not the factual basis for a claim against CLA. EPIC first focused on minimizing the damage, which it did.

Once EPIC minimized the damage, it hired Couch to determine if CLA did anything wrong in not alerting EPIC to the mismanagement earlier. It took Couch several months to see what CLA did and did not do.

The mere fact that CLA’s audits from 2007-2010 did not mention any mismanagement did not necessarily alert EPIC that CLA committed malpractice. It took Couch several months to determine how the mismatching occurred and that a competent auditor could have discovered the misuse of grant funds after commencing her work in September 2013. EPIC, exercising due diligence, should not have been aware of the factual

basis of its claims prior to December 2012, three years prior to commencement of the action.

CLA is free to argue EPIC should have been able to determine, with reasonable diligence, CLA's alleged malpractice prior to December 2012, more than three years prior to commencement of the action. That is a factual issue a court cannot determine on summary judgment.

5. EPIC has asserted a breach of contract claim with a six-year statute of limitations.

EPIC has valid claims in contract for malpractice by CLA in the audits for years 2009-2010. A claim of professional malpractice may sound in contract or tort. *See Owens v. Harrison*, 120 Wn.App. 909, 915, 86 P.3d 1266 (2004). Whether the action sounds in contract depends upon whether the plaintiff alleges and the evidence shows the defendant breached a specific term of the contract. *Id.*

A breach of contract claim requires (1) a valid contract, (2) breach, and (3) damages resulting from the breach. Here, EPIC's contract with CLA is undisputed, and for purposes of CLA's motion to have the claim dismissed, so is CLA's breach of duty. EPIC's damages were the loss of grant funding, both funds returned and declining to seek additional grant funding in 2013 and 2014.

EPIC is asserting CLA violated a specific contractual provision regarding federal funding contained in the engagement letters, supporting EPIC's breach of contract claim arising out of CLA's malpractice. CLA tacitly acknowledged this specific duty when it included the failure to properly handle federal funding in its 2011 audit.

EPIC's claims for malpractice in the 2009 and 2010 audits, failing to uncover and disclose the misuse of grant funds, was a breach of a written contract. It was subject to the 6-year statute of limitations. RCW 4.16.040(1). The action was commenced within six years of the breaches.

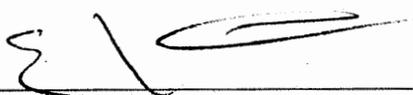
E. Conclusion

EPIC asserted valid claims against CLA for damages it incurred due to the malpractice by CLA. The trial court wrongly denied EPIC its opportunity to obtain an adjudication on the merits.

The 2-year limitations period in the audit letters, which expired by the time EPIC was damaged by CLA's conduct, was not enforceable. The 3-year limitations period did not commence until EPIC "discovered" the factual basis for its negligence claims. Finally, EPIC was entitled to assert a breach of contract claim arising out of CLA's malpractice.

DATED this 30th day of September, 2016.

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