

FILED

APR 28 2017

COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

NO. 348288

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION THREE

CORNERSTONE EQUITIES, LLC, a Washington Limited Liability
Company, KEITH SCRIBNER and JANE DOE SCRIBNER, husband
and wife, Plaintiffs-Respondents/Cross-Appellants

v.

MAHLEN INVESTMENTS, INC., a Washington Corporation,
and CRAIG L. MAHLEN and KAREN I. MAHLEN, husband and wife,
Defendants-Appellants

ON APPEAL FROM THE SUPERIOR COURT OF THE STATE OF
WASHINGTON FOR SPOKANE COUNTY

The Honorable John O. Cooney, Judge

**REPLY BRIEF OF CROSS-APPELLANT
CORNERSTONE EQUITIES, LLC**

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I.

INTRODUCTION

Mahlen mounts two arguments in opposition to Cornerstone's Cross-Appeal. First, Mahlen incorrectly argues that Cornerstone's Cross-Appeal is bared by RAP 2.5(b)(1)(ii). That argument fails because Cornerstone's right to appeal is specifically authorized by RAP 2.5(b)(1)(iii) relieving it of any requirement for the bond referenced in RAP 2.5(b)(1)(ii).

Second, Mahlen argues that Cornerstone suffered no damage because the cost to complete Cornerstone's portion of the drive-thru would have been so high that Cornerstone would have realized no *profit*. This argument is curious indeed since Cornerstone has not claimed *profit* nor is this case about *profit*.

In support of Mahlen's second argument it cites 104 year old *Gould v. McCormick*, 75 Wash. 61, 134 P. 676 (1913). Although the law is still good, the case involves breach of a construction contract rather than a written lease. Accordingly, it does nothing to support Mahlen's argument on damages. "Profit", as that term is use in *Gould*, is not an element of this case now on review. Mahlen's argument totally ignores the very real distinction between the "rental income" Mahlen

was to pay under the lease and “profit” expected to be earned from a construction contract. Rent and profit are not synonymous.

What Mahlen labels as Cornerstone’s “cost” is really a “capital expenditure”, a fact also ignored by Mahlen. Money spent by Cornerstone to improve its own property by paving the 12 foot section would be an investment, not a lost expense as would have been incurred by the contractor in *Gould*. Mahlen also failed to take into account the economic realities of “net operating income” as the key element in determining “project value”, which is the true goal of a landlord rather than “rent” in the abstract which is only a means to determining project value.

Finally, the cost to Cornerstone of paving the 12 foot strip was not an issue at trial. Some of the testimony and exhibits, introduced for the purpose of showing what Cornerstone had done towards fulfilling its end of the bargain, contained reference to bids for certain portions of work. But that evidence was offered to establish what Cornerstone was doing, not what the drive-thru, and more importantly, Cornerstone’s portion of the drive-thru, would cost. There wasn’t even any evidence that any of the bids referred to in Mahlen’s brief were ever even accepted by Cornerstone. There was no finding on what Cornerstone’s portion of the drive-thru would cost nor did Mahlen ask for such finding.

Mahlen's answer, affirmative defenses and counter-claim all fail to set up the issue of Cornerstone's cost to pave the 12 foot strip. (CP 20-30). To raise this issue for the first time on appeal is impermissible. In *Mukilteo Retirement Apartments, LLC v. Mukilteo Investors LP*, 176 Wn.App. 244, 246, 310 P.3d 814 (2013), Division 1 rejected a litigants attempt to, for the first time on appeal, argue a claim which was neither raised within the pleadings nor litigated at trial by either implied or express consent, noting that it was not permitted under RAP 2.5(a)(2).

II

ARGUMENT

A. RAP 2.5(b)(1)(iii) Permits Cornerstone's Appeal

RAP 2.5(b)(1)(iii) provides that a party may accept the benefits of a trial court decision without losing the right to obtain review if, regardless of the result of the review **based solely on the issues raised by the party accepting benefits**, the party will be entitled to at least the benefits of the trial court decision. The trial court awarded Cornerstone \$102,498.50 which Mahlen paid. After Mahlen appealed, Cornerstone filed a Cross-Appeal seeking to recover additional rent not awarded by the trial court. Based solely on the issues raised by Cornerstone in its Cross-Appeal, Cornerstone will be entitled to at least the benefits of the trial court decision, whether this Court affirms or reverses.

The only issue raised by Cornerstone in its Cross-Appeal is whether or not it should have been awarded more rent than the trial court awarded. If this Court decides in favor of Cornerstone the matter will be remanded for additional damages. If, on the other hand, this reviewing Court determines that the trial court's decision was correct, Cornerstone will still be entitled to at least the benefits of the trial court's decision, based on the issues raised by Cornerstone's Cross-Appeal. Accordingly, *La Rue v. Harris*, the sole case cited by Mahlen on the issue, does not apply¹.

B. Mahlen's Breach Relieved Cornerstone of Any Obligation to Further Pursue the Drive-Thru or To Accept Rent at Half The Lease Rate

Mahlen's argument is based on one fallacy after another. First, Mahlen argues that Cornerstone seeks double the rent that was owed at the time of Mahlen's breach. (P. 42, Mahlen Reply Brief). Not so. Cornerstone only seeks rent at the rate stated in the lease from the time of Mahlen's June, 2014 breach. Cornerstone does not seek full rent during the time that it was endeavoring to vacate the alley so it could pave the 12 foot strip.

¹ Besides, the issue in *LaRue* was whether the party who paid the judgment could pursue an appeal not, as here, the party who accepted the benefits of the judgment.

Moreover, Mahlen confuses “rent” with “profit”. (P. 42, Mahlen Reply Brief). Profit and rent is not the same thing. Further, any attempt to measure damages caused by Mahlen’s breach of its lease by speculating as to the capital cost of the work Cornerstone was to perform on its own property towards Mahlen’s drive-thru is nonsensical. There clearly is no measure by which one compares the capital cost of improvements to be made to one’s property to the rental amount to be paid in order to determine a landlord’s damages upon breach by the tenant. Certainly, there is no measure by which one calls rent “profit” and compares it dollar for dollar against the speculative cost of capital improvements. The primary measure of damages for breach of a lease is the unpaid rent.

Nor are costs incurred by Cornerstone in paving *expenses*. They are capital improvements and as such may be depreciated. Further, rent is capitalized to create an overall value of the project for purposes of resale. A contractor who incurs “expenses” in attempting to realize a “profit” from a discrete construction project is in a totally different situation. In the case of Cornerstone which purchased land and constructed a building, its return, based upon rent, cannot be calculated strictly on the cost of paving the 12 foot strip but must include the investment in the land and the building shell. There is no evidence

before the Court on those costs. Mahlen's attempt to equate rent with profit, a construction contract with a lease, and expenses with capital improvements are senseless.

In fact, since Cornerstone was only obligated to pave a 12 foot strip and Mahlen was obligated to do all other things necessary to implement the drive-thru, the value of Cornerstone's property would have been greatly enhanced by Mahlen's full performance over and above its payment of rent. However, Cornerstone did not sue for that loss of value as it is not a measure of damages for a breach of lease. This case is about rent, common area expenses and fraud, all issues framed by the pleadings.

It must again be noted that under Schedules "C" and "D" Cornerstone's obligation pertaining to Mahlen's drive-thru was *limited* to simply paving the 12 by 45 foot section and installing a window. (RP 42;23- 43;1) (Plts. Ex 1, p. 44) (RP 43;2-4) (RP 44;12-45;2) (Plts. Ex 1, p. 45). Mahlen admitted that the strip was only *part of* a drive-thru to allow patrons to drop-off and pick-up laundry. (RP 252; 17-25); (RP 108; 9-11).

Additionally, there was no evidence offered at trial regarding the factors on which Cornerstone based the rent. There is no evidence that what was believed to be a short term rent concession had any

relationship to the cost of Cornerstone's limited contribution towards Mahlen's drive-thru, which, as is noted above, would actually constitute an investment by Cornerstone in its own property---hardly the definition of an expense.

To merely presume that the value of Cornerstone's portion of the drive-thru was equal to one half of the total monthly rent based only upon Cornerstone's temporary willingness to compromise the rent to keep a long term tenant ignores the method in which buildings are valued for future sales using capitalization of net income to arrive at value. All of this, beginning with Mahlen's guesses at cost, is rank speculation totally devoid of any evidentiary support and irrelevant². Accordingly, Mahlen's entire argument has been shown to be meritless and fails.

When Mahlen breached, Cornerstone's obligation to continue its efforts to pave the strip as well as its promise to collect rent at 50% of the rate stated in the lease obviously ended. Cornerstone was no longer

² For example, if one takes the \$49,202 which Mahlen argues that Cornerstone would "make" (P. 44 of Mahlen's Reply Brief), and divide it by half to reflect the additional rent to which Cornerstone is entitled under the lease (which would be "net" income since it would be on top of other income from where expenses had already been taken), and if one were to capitalize that amount at the conservative rate of 6%, the value added to the building by that additional rent now sought would be \$408,333.

obligated to vacate the alley or pave the 12 foot strip due to Mahlen's actions alone and those actions cannot require Cornerstone to collect half rent for the remainder of the lease term. Having been relieved of the obligation to pave or install the sign, Mahlen removed those elements from the equation. As noted in Cornerstone's Brief, unopposed by Mahlen, a material breach by one party discharges the other's obligation. *Jacks v. Blazer*, 39 Wn.2d 277, 285, 235 P.2d 187 (1951). Mahlen's breach excused Cornerstone from further performance. (CL 31 at CP 877).

III

CONCLUSION

Mahlen presented illogical and inappropriate arguments on the correct measure of damage for breach of a written lease. This Court is asked to reject Mahlen's arguments and to reverse the trial court on the issue of damages to be awarded to Cornerstone and remand for further proceedings in accordance with this Court's directive to increase rent damage to the full amount called for in the lease from the time of breach.

DATED this 25th day of April, 2017



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MAHLEN INVESTMENTS, INC., a
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MAHLEN and KAREN L. MAHLEN,
husband and wife,
Defendants-Appellants,

Case No: 348288

**CERTIFICATE OF SERVICE OF
REPLY BRIEF OF CROSS-
APPELLANTS**

CERTIFICATE OF SERVICE

I certify that I served a true and correct copy of the foregoing **REPLY BRIEF OF CROSS-APPELLANTS** by the method indicated below, and addressed to the following:

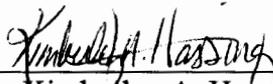
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 via Facsimile
 Overnight delivery via UPS

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

Signed at Roseville, California this 25th day of April, 2017



Kimberley A. Hassing,
Paralegal to Steven J. Hassing