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COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

59024-3

LAURA HOLDEN, *et al.*,

Respondents,

vs.

FARMERS INSURANCE COMPANY OF WASHINGTON, a
domestic insurer; FARMERS INSURANCE EXCHANGE, a
foreign insurer; and all affiliated Farmers Insurance Companies
and/or entities

Appellants.

BRIEF FOR APPELLANTS

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TABLE OF CONTENTS

	Page
I. INTRODUCTION	1
II. ASSIGNMENTS OF ERROR.....	2
III. STATEMENT OF THE CASE	3
A. The Policy	3
B. Washington’s Regulation Of Fire Insurance Policies.....	4
C. Holden’s Claim.....	7
D. Procedural History	9
IV. ARGUMENT.....	11
A. The Superior Court Improperly Disregarded the Supreme Court’s Holding in <i>Solomon</i>	11
B. Sales Tax Is Not Part Of ACV Of An Insured’s Loss.....	13
V. CONCLUSION	19

TABLE OF AUTHORITIES

	Page
CASES	
<i>Aaro Medical Supplies, Inc. v. State Dept. of Revenue</i> , 132 Wn. App. 709, 132 P.3d 1143 (2006).....	15
<i>Cascade Court Ltd. P'ship v. Noble</i> , 105 Wn. App. 563, 20 P.3d 997 (2001).....	14
<i>Crystal Chalets Ass'n v. Pierce County</i> , 93 Wn. App. 70, 966 P.2d 424 (1998).....	14
<i>DePhelps v. Safeco Ins. Co. of Am.</i> , 116 Wn. App. 441, 65 P.3d 1234 (2003).....	5, 13
<i>Egerer v. CSR West, LLC</i> , 116 Wn. App. 645, 67 P.3d 1128 (2003).....	14
<i>Ghoman v. New Hampshire Ins. Co.</i> , 159 F. Supp. 2d 928 (N.D. Tex. 2001)	16-17
<i>Hess v. N. Pac. Ins. Co.</i> , 122 Wn.2d 180, 859 P.2d 586 (1993).....	6, 12-13, 17
<i>Higgins v. Ins. Co. of N. Am.</i> , 256 Or. 151, 469 P.2d 766 (1970)	6
<i>National Fire Ins. Co. v. Solomon</i> , 96 Wn.2d 763, 638 P.2d 1259 (1982).....	<i>passim</i>
<i>Russell v. Arkansas</i> , No. CR 06-180, 2006 Ark. LEXIS 555 (Ark., Nov. 2, 2006).....	17
<i>State Farm Mut. Auto. Ins. Co. v. Berthelot</i> , 732 So.2d 1230 (La. 1999)	15-18
<i>State v. Rowley</i> , 74 Wn.2d 328, 444 P.2d 695 (1968).....	14

TABLE OF AUTHORITIES

(continued)

Page

Terra Indus., Inc. v. Commonwealth Ins. Co.,
981 F. Supp. 581 (N.D. Iowa 1997) 11

STATUTES

RCW 48.18.120(1) 5

WAC 284-20-010 5

MISCELLANEOUS

Allen D. Windt, *INSURANCE CLAIMS & DISPUTES*, § 6:02, at 625
n.61 (3rd ed. 2001 & Supp. 2006) 11

I. INTRODUCTION¹

This putative class action turns on a single issue of law, which was decided on cross-motions for summary judgment by the King County Superior Court (Hon. John Erlick) on September 8, 2006 (the “Summary Judgment Order”).² That order held that “actual cash value” (“ACV”), as used in the statutorily-mandated terms of the homeowner’s insurance policy of Respondent, Laura Holden (“Holden”), and other members of the putative class, includes a portion of the sales tax they would have to pay if they replaced the damaged property.³

The Washington Supreme Court held in *National Fire Insurance Company v. Solomon*, 96 Wn.2d 763, 770, 638 P.2d 1259 (1982), that the phrase “actual cash value” as used in statutorily-mandated language of fire

¹ The record in this case is composed of Clerk’s Papers and a Transcript of the argument on summary judgment. The Clerk’s Papers are consecutively paginated and are cited CPyy:zz where “yy” is the page number and “zz” is the line number on the page. The Transcript is cited Tyy:zz, where “yy” is the page number, and “zz” is the line number on the page. If the citation is to an entire page or if the lines are not numbered, the line numbers may be omitted. Some of the Clerk’s Papers are copies of condensed deposition transcripts, with multiple deposition pages on one clerk’s page. In such cases, the cite will be CPxx ([deponent), at yy:zz, with “xx” the initial page of the deposition in the Clerk’s Papers, “yy” the page in the deposition transcript, and “zz” the line number on that page.

² CP19-43; CP407-423; CP522-65; CP569-73; CP582-86

³ CP585; T79:4-9.

insurance policies (like the one here) means “fair market value” (“FMV”) and not “replacement cost, less depreciation.” Holden’s policy reflects that definition.⁴ Washington law holds that sales tax is not included in fair market value.

But the superior court found *Solomon’s* holding no longer controlling.⁵ It then reasoned that the phrase “actual cash value” is vague and ambiguous, and that a reasonable interpretation of the term is “replacement cost, less depreciation.”⁶ Because “replacement cost” includes all transactional costs, such as sales tax, the superior court held that a reasonable insured would expect sales tax in the ACV settlement of his/her fire insurance claim.⁷ This court allowed discretionary review.

II. ASSIGNMENTS OF ERROR

The superior court erred in disregarding the Supreme Court’s decision in *Solomon* and holding that an insurer must include an allowance for sales tax in determining the “actual cash value” of damage to insured property.

⁴ C93.

⁵ T74:4-75:15.

⁶ T75:16-78:21.

⁷ T78:22-79:9.

III. STATEMENT OF THE CASE

A. The Policy

Holden's lawsuit is based upon a claim for a fire loss to personal property (contents) after a fire in her home.⁸ Holden is insured by Farmers Insurance Company of Washington ("FICW") under a Broad Form Renters Package Policy, Policy number 92628-08-69 ("Policy").⁹ The Policy contains the following provision on Loss Settlement:

Covered loss to property will be settled at *actual cash value*. Payments will not exceed the amount necessary to repair or replace the damaged property, or of the limit of insurance applying to the property, whichever is less.

(emphasis added).¹⁰

"**Actual Cash Value**" is defined in the policy as the "fair market value of the property at the time of the loss."¹¹

Holden also purchased a Contents Replacement Cost Coverage endorsement, which states:

⁸ CP9:9-10;

⁹ CP9:11-16; CP15:12-18; C89-118. FICW is an affiliate of Farmers Insurance Exchange, which is also named as a defendant. For purposes of this appeal, the involvement of Farmers Insurance Exchange has no impact, so the fact statement and argument will speak only of FICW.

¹⁰ CP99.

¹¹ CP93.

**CONTENTS REPLACEMENT COST COVERAGE
PERSONAL PROPERTY**

For an additional premium, insurance ... is extended to include the full cost of repair or replacement without deduction for depreciation:

* * *

Definition: "replacement cost" means the cost, at the time of loss, of a new article identical to the one damaged, destroyed or stolen. When the identical article is no longer manufactured or is not available, replacement cost shall mean the cost of a new article similar to that damaged or destroyed and which is of comparable quality and usefulness.

* * *

The Company will not be liable for any loss under this endorsement unless and until actual repair or replacement is completed. The named insured may elect to disregard replacement cost in making claim hereunder but such election shall not prejudice the named insured's right to make further claim under this replacement cost provision within 180 days after the loss.¹²

¹² CP118.

B. Washington's Regulation Of Fire Insurance Policies

Holden's policy insured her personal property against fire, among other perils.¹³ Washington strictly regulates the terms of fire insurance policies. RCW 48.18.120(1) authorizes the Insurance Commissioner to promulgate regulations "to define and effect reasonable uniformity in all basic contracts of fire insurance." The Commissioner exercised that authority by promulgating WAC 284-20-010. This governs "all policies which include coverage against loss or damage by fire." *Id.*, subd. (2). It requires use of the 1943 New York Standard Fire Insurance Policy, to be known as the "standard fire policy." *Id.*, subd. (3). But insurers may also use "a form written in clear, understandable language, which provides terms, conditions, and coverages not less favorable than the 'standard fire policy.'" *Id.*, subd. (3)(c). "Such alternative form may be incorporated in or integrated within a form providing other or additional coverages, such as for example, a homeowners policy." *Id.*

¹³ CP96.

The standard fire policy provides coverage for the “actual cash value” of the insured property.¹⁴ It provides only indemnity for the actual amount of the insured’s loss. *DePhelps v. Safeco Ins. Co. of Am.*, 116 Wn. App. 441, 454, 65 P.3d 1234 (2003). Replacement cost coverage is an optional, extra cost coverage, providing benefits only payable if the insured actually replaces. *Hess v. N. Pac. Ins. Co.*, 122 Wn.2d 180, 189-90, 859 P.2d 586 (1993), following *Higgins v. Ins. Co. of N. Am.*, 256 Or. 151, 162-67, 469 P.2d 766 (1970).

The Supreme Court construed the standard fire policy term “actual cash value” in *National Fire Insurance Company v. Solomon*, 96 Wn.2d 763, 770, 638 P.2d 1259 (1982). The policy provided replacement cost coverage, but the insurer sought to condition payment on actual repair or replacement. *Solomon* held that the condition was not authorized by the policy language. But it also held that the insured would have been entitled to the policy limit, even under the statutory minimum ACV coverage. The court adopted a California court’s holding, construing a similar standard

¹⁴ The Washington Department of Insurance posts a copy of the New York Standard Fire Policy on its website, at <http://www.insurance.wa.gov/industry/ratesformsdocs/NYStandardFirePolicy.pdf>. The fact that it insures only the actual cash value of the insured property is stated in the first textual paragraph.

fire policy, “that ‘actual cash value’ within statutory language of fire policy is synonymous with ‘fair market value.’” *Id.*

Prior to 1983, FICW’s homeowners policies defined ACV as “replacement cost of the property at the time of loss, less depreciation.”¹⁵ In response to *Solomon*, FICW endorsed all of its policy forms to adopt the *Solomon* definition: FMV.¹⁶

Around 1985, the Washington Department of Insurance (the “DOI”) demanded that FICW incorporate this and other amendments contained in the endorsement in the policies themselves.¹⁷ FICW complied with the DOI’s demand, and began issuing Washington-specific homeowner-type policies that define ACV as “fair market value of the property at the time of loss” directly in the affected policies.¹⁸ Holden’s policy and all other current policies so provide.¹⁹

¹⁵ CP368:3-4.

¹⁶ CP368:5-9.

¹⁷ CP368:10-12.

¹⁸ CP368:2-15.

¹⁹ *Id.*

C. Holden's Claim

A fire occurred at Holden's apartment on June 9, 2004.²⁰ She submitted a claim for certain personal property items destroyed in the fire. FICW paid her \$1,174.41 as the ACV of those items.²¹ Holden was twice advised by letter that, if she replaced the damaged items, she could make a further claim for replacement cost (less the payment already made) and that the replacement cost payment would include sales tax.²² She was invited to submit receipts reflecting her cost of replacement.²³ She never did, and the time for doing so has expired.²⁴ So, she is entitled only to ACV. She does not dispute FICW's determination of the ACV of her property, except for the failure to include any allowance for sales tax in the payment.²⁵

Before filing suit, Holden complained to the Washington Insurance Department, writing at least three letters to Ethel Smith of the Insurance

²⁰ CP9:9-10; CP28: 9-10.

²¹ CP10 1-3; CP16:1-2.

²² CP370:1-17; CP392-406.

²³ *Id.*

²⁴ CP370:18-20.

²⁵ CP10:4-14

Commissioner's office.²⁶ Ms. Smith forwarded each letter to FICW, asking it to respond.²⁷ FICW did so, specifically stating that sales tax was not payable unless and until actually incurred, at which time the replacement cost coverage would be applicable.²⁸ The DOI never took exception to FICW's position on this.²⁹

D. Procedural History

In this putative class action, Holden seeks a declaration that payment of the sales tax she demands should have been included in the ACV settlement of her claim, as well as similar relief for all those similarly situated.³⁰ After discovery, FICW and Holden filed cross motions for summary judgment.³¹ The sole issue on both motions was whether the ACV computation of losses under Holden's insurance policy should include sales tax.

²⁶ CP304:23 to 306:8; CP309-19; CP325-55; CP362-63.

²⁷ CP304:23 to 306:8; CP308; CP324; CP361.

²⁸ CP304:23 to 306:8; CP321-23; CP358-59; CP365-66.

²⁹ CP306:9-10.

³⁰ CP12:4-12.

³¹ CP19-43; CP407-23.

The Summary Judgment Order granted Holden's motion and denied FICW'S.³² The court found that *Solomon* did not bind it: "*Hess v. North Pacific Insurance Company*, in this Court's opinion, if not *sub silentio* overruling *Solomon*, at least significantly limits it."³³ Farmers itself used multiple methodologies, including replacement cost less depreciation, to estimate FMV.³⁴ In the court's mind, that meant that FMV was ambiguous, that replacement cost less depreciation was one

³² CP586:2-5.

³³ T74:4-6.

³⁴ T75:16-20. There is no completely reliable way to determine the actual cash value of used personal property. FICW uses a number of methods of estimating that value, including (1) surveying secondary markets, such as e-Bay, Craig's list, and classified ads; (2) hiring an appraiser; (3) agreeing with the insured on value; or (4) taking the cost of a comparable new item and depreciating for age, obsolescence, wear and tear, etc. CP368:16-21. The method used depends on the type of property and whether it is readily found in a secondary market or susceptible to appraisal (e.g., a collectible watch). CP368:22 to 369:3. Property (e.g., an old toaster) with intrinsic value but neither found in secondary markets nor susceptible of appraisal may be best valued by replacement cost less depreciation. CP368:22 to 369:3. Property with primarily personal value, such as family photos, may have to be valued by agreement. CP368:22 to 369:3. Whenever FICW and the insured cannot agree on value, the standard fire policy provides for appointment of competent and disinterested appraisers, and Holden's policy complies with that requirement. CP246, ¶ 9; Standard Fire Policy, Lines 123-40.

reasonable interpretation, and that the ambiguity should be construed in favor of the insured.³⁵

On October 12, 2006, the superior court, on FICW'S motion, entered the Certification Order certifying the Summary Judgment Order for immediate appeal pursuant to RAP 2.3(b)(4). The Certification Order stayed all further actions in the superior court (with regard to class certification or otherwise) pending appeal. On January 16, 2007, this Court granted discretionary review of the Summary Judgment Order.

IV. ARGUMENT

A. **The Superior Court Improperly Disregarded the Supreme Court's Holding in *Solomon***

The superior court implicitly criticized FICW for using what the court regarded as a vague and ambiguous definition of ACV, to wit, FMV. It ignored the fact that FICW is required by law to specify coverage based on ACV, ignored the fact that this legally mandated term was defined by the Supreme Court in *National Fire Insurance Company v. Solomon*, 96 Wn.2d 763, 770, 638 P.2d 1259 (1982), and ignored the fact that the DOI had required FICW to use exactly the definition the court criticized. The superior court also ignored the fact that *Solomon* specifically held that "actual cash value" within statutory language of the fire policy ... does

³⁵ T76:3-13; T78:3-10.

not mean replacement cost less depreciation.” *Id.* *Solomon* further held that interpreting the term to mean “fair market value” was proper because that was the meaning that would “do justice to all parties.” *Id.* at 771.

The rule that ambiguous policy language is construed against the insurer applies only where the insurer chose that language. Where the language is imposed by law, that language is construed under the principles of statutory construction, and is not construed against the insurer. *Terra Indus., Inc. v. Commonwealth Ins. Co.*, 981 F. Supp. 581, 590 (N.D. Iowa 1997) (and cases collected there and in ALLEN D. WINDT, *INSURANCE CLAIMS & DISPUTES*, § 6:02, at 625 n.61 (3rd ed. 2001 & Supp. 2006)). *Solomon* applied the principles of statutory construction and determined the definition of ACV.

The superior court believed that it was not bound by *Solomon*, because *Solomon* had been effectively overruled by *Hess v. North Pacific Insurance Co.*, 122 Wn.2d 180, 189-90, 859 P.2d 586 (1993). The superior court failed to appreciate that *Solomon* had at least two holdings, and only holdings on issues other than ACV were affected by *Hess*. *Solomon's* definition of ACV is still good law.

The policy in *Solomon* provided replacement cost coverage, but offered ACV as an alternate measure of loss if the property was not repaired or replaced. It did not expressly condition recovery of

replacement cost on repair or replacement. 96 Wn.2d at 765. The Supreme Court held that the insureds could recover replacement cost regardless of whether they rebuilt. *Id.* at 769-70. It also held that the insured was entitled to recover the full policy limit even under the statutory minimum ACV coverage, because ACV meant FMV, *Id.* at 770-72, and the insurer itself had determined that FMV exceeded the policy limit. *Id.* at 766.

In *Hess*, the Court considered only whether an insurer, by suitable express language, could validly condition replacement cost coverage on actual repair or replacement. It held that this was proper. 122 Wn.2d at 186-92. It distinguished *Solomon* based on the lack of such express language, and limited *Solomon's* holdings to *Solomon's* particular facts. *Id.* at 191.

There was no issue in *Hess* regarding the definition of ACV, so *Hess's* limitation of *Solomon's* holdings did not affect the definition of ACV. *Solomon's* definition of ACV remains good law.

Moreover, the DOI never demanded that FICW change its practices in light of *Hess*, while it did make such a demand in response to the seminal holding of *Solomon*. So the DOI apparently does not believe that *Solomon's* definition of ACV has been overruled. And even if

Solomon is overruled on that point, its definition has been expressly incorporated in Holden's policy.

B. Sales Tax Is Not Part Of ACV Of An Insured's Loss

Insurance coverage for the ACV of the insured property provides only indemnity for the actual amount of the insured's loss. *DePhelps*, 116 Wn. App. at 454. The value protected is the economic loss to the insured, which is the FMV of the loss. *Solomon*, supra. In other words, the measure of the loss is what the insured could have sold the property for before the loss, less any remaining value after the loss. Washington law defines FMV as the amount of money which a purchaser willing but not obliged to buy would pay a seller willing but not obliged to sell. *Cascade Court Ltd. P'ship v. Noble*, 105 Wn. App. 563, 567, 20 P.3d 997 (2001); *Crystal Chalets Ass'n v. Pierce County*, 93 Wn. App. 70, 77, 966 P.2d 424 (1998); *State v. Rowley*, 74 Wn.2d 328, 334, 444 P.2d 695 (1968).

In a different context, this Court has held that FMV does not include sales tax. *Egerer v. CSR West, LLC*, 116 Wn. App. 645, 656-657, 67 P.3d 1128 (2003). In *Egerer*, a seller failed to deliver goods, and the buyer, who had not covered by purchasing elsewhere, was permitted to recover the market price of such goods (so-called hypothetical cover). The buyer sought to recover the sales tax it would have paid had it

purchased those goods, but this Court denied any claim for never-paid sales tax:

An award of damages may include an amount for sales tax actually incurred by the injured party. But Egerer did not actually incur any obligation to pay sales tax The sales tax is not an inherent part of the “market price.”

Id. Had Egerer been permitted to recover sales tax that he had not paid to purchase replacement goods, the damage payment would actually have put him in a better position than had there been no breach (in which case Egerer would have paid the sales tax on the goods CSR would have delivered).

This point that sales tax is not included in market value is even more clearly true here. The logic of *Solomon* requires that Holden’s loss be valued by treating Holden as a potential seller of the damaged property, who would receive less on account of the damage. A buyer of property must pay sales tax to the seller, but the seller must remit that tax to the state. *Aaro Medical Supplies, Inc. v. State Dept. of Revenue*, 132 Wn. App. 709, 716, 132 P.3d 1143 (2006). Holden would not have benefited from any sales tax on the hypothetical sale, and that tax was not part of her loss.

To be sure, if Holden replaces the damaged property, she will incur sales tax on her purchase(s). But ACV insurance coverage is not

concerned with the cost of replacement. That is the subject of the optional endorsement that Holden purchased, but chose not to take advantage of. Had she done so, FICW would have paid the full cost of replacement, including sales tax.

Washington courts have not had occasion to apply these principles in the context of an insurance claim. Indeed, there appears to be only one case in the whole country that has done so where actual cash value was defined as FMV. Under that definition, the Louisiana Supreme Court held in *State Farm Mutual Automobile Insurance Co. v. Berthelot*, 732 So.2d 1230, 1235-37 (La. 1999), that sales tax is not included in the computation of ACV. The court ruled that sales tax is not a part of the value of the damaged property, but is “a distinct and separate charge which the retail seller is required to collect as a pass-through for the benefit of the state or locality.” *Id.* at 1234-35. It does not increase the value of property that is later damaged:

[W]hile it may be said that sales tax may increase the cost to the buyer in the retail market, it is equally clear that it does not increase the value of the property purchased. Simply stated, [. . .] a sales tax is a mandatory cost which state and local governments have added to the sale transaction, over and above the value of the purchased property. Accordingly, *the inescapable conclusion is that Franklin’s vehicle did not have a higher value when it was totalled simply because a sales tax was paid when it was originally purchased, nine years earlier.*

Id. at 1235 (emphasis added).

The court in *Ghoman v. New Hampshire Insurance Company*, 159 F. Supp. 2d 928 (N.D. Tex. 2001), held otherwise, but it defined ACV as “replacement cost, less depreciation.” *Id.* at 934. Because that definition deviates from *Solomon’s* definition, *Ghoman* is inapposite. Replacement cost does include sales tax, and reducing that amount by a depreciation percentage would still leave a portion of that sales tax in the computed ACV. But there is no basis for including sales tax when ACV is defined as FMV.

Berthelot was followed, in a criminal context, by the Arkansas Supreme Court in *Russell v. Arkansas*.³⁶ That was a theft case in which the issue was whether the property stolen was worth more than \$500 (a felony) or less (a misdemeanor). The property was a generator, purchased for \$499.99, plus sales tax of \$39.19. Agreeing with *Berthelot*, the Arkansas court held that “the sales tax is a cost imposed on the transaction. It does not in any way increase or enhance the ‘value’ of the property.”³⁷ So the generator was not worth \$500 and the offense was

³⁶ *Russell v. Arkansas*, No. CR 06-180, 2006 Ark. LEXIS 555 (Ark., Nov. 2, 2006).

³⁷ *Id.* at *14.

only a misdemeanor. The court also collected authority showing that this rule is generally followed in criminal cases.³⁸

The superior court chose to follow *Ghoman*, despite its deviation from the *Solomon* definition. It felt free to do that because it regarded *Hess* as having rendered *Solomon* inoperative, which *Hess* did not do on this issue. The superior court also distinguished *Berthelot* on the ground that Louisiana follows the civil law, rather than the common law.³⁹ But *Berthelot* did not employ any distinctive civil law principles, and it did employ the same definition of ACV as the Supreme Court adopted in *Solomon*. So *Berthelot* is the more apposite case.

The superior court may also have thought that FICW's claim practices showed the existence of an ambiguity. The record showed that FICW issues policies, unlike Holden's policy, providing only ACV coverage (and not replacement cost coverage). Under such policies, FICW does pay a fraction of the sales tax (reflecting the depreciation percentage) when the insured actually replaces and provides copies of the receipts to FICW.⁴⁰ Of course, that shows only what FICW pays when its

³⁸ *Id.* at *7-8.

³⁹ T64:9-11.

⁴⁰ CP120 (Hower), at 35:14 to 36:8.

insured has incurred a loss by actually paying sales tax, something Holden never did. And it may be that FICW is overpaying insureds with ACV policies who actually replace. Even so, that does not require FICW to overpay insureds with replacement cost policies who do not replace.

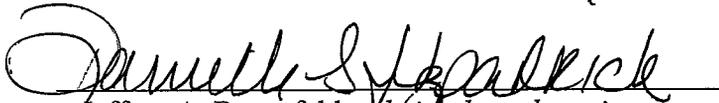
Any supposed ambiguity does not matter, because use of the term ACV is statutorily mandated and that term has been construed by the Supreme Court, in *Solomon*. That construction controls, even if FICW may have misunderstood the definition's application to purely ACV policies.

V. CONCLUSION

Based on the foregoing, FICW respectfully requests that this Court reverse the summary judgment granted to Holden and enter or direct the superior court to enter summary judgment for FICW.

RESPECTFULLY SUBMITTED this 31st day of May, 2007.

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CERTIFICATE OF SERVICE

I hereby certify that on the 31st day of May, 2007, I caused to be served a true and complete copy of the foregoing **BRIEF FOR APPELLANTS** on counsel of record at the address and in the manner shown below:

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