

No. 83690-6

SUPREME COURT OF THE STATE OF WASHINGTON

COURT OF APPEALS OF THE  
STATE OF WASHINGTON, DIVISION III

Cause No. 272010

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STATE OF WASHINGTON  
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ELCON CONSTRUCTION, INC.

Appellant,

v.

EASTERN WASHINGTON UNIVERSITY,

Respondent.

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**ELCON CONSTRUCTION'S SUPPLEMENTAL BRIEF**

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**ORIGINAL**

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## **I. IDENTITY OF PETITIONER**

Appellant Elcon Construction, Inc., by and through its attorneys  
Dunn & Black, P.S., files this Supplemental Brief.

## **II. ISSUES PRESENTED FOR APPEAL**

1. Does fraud, resulting in a party being induced into a contract, arise from an independent duty such that the Economic Loss Rule does not apply?
2. Did genuine issues of material fact exist with regard to the damages Elcon incurred as a result of EWU's intentional interference with its contractual relationships?
3. Is a public works contractor entitled to statutory interest when it is confirmed a Public Body did not pay amounts owed?
4. Does a Superior Court retain jurisdiction to decide statutory interest after an Arbitrator confirms contract payments were owed?
5. Does a Superior Court retain jurisdiction to decide statutory interest when that issue was not previously submitted to or decided by Arbitration?

## **III. RE-STATEMENT OF THE CASE**

In 1999, EWU hired an engineering firm to produce a Water Capacity Study (*"the Study"*). CP 624-636. The Study included an in-depth analysis of how to develop additional groundwater capacity either from EWU's existing wells or potentially from a new well. CP 534-607. See also CP 608-623; CP 695-696. The Study contained critical

information about what would be required to obtain water from the Grand Ronde Aquifer on the EWU campus. CP 564-588. As a result, EWU had a plethora of information about the local hydrogeology, the depths necessary to obtain water from a new Grande Ronde well, and the limited likelihood of obtaining water from such a campus well.

EWU decided to drill two *new* campus wells into the Grand Ronde Aquifer. CP 695-698. EWU's design parameters for the *new* wells specified two 750' deep wells to be bid on a per foot unit price basis. CP 671. Notably, this depth is through the Wanapum and into the Grande Ronde Aquifer. How EWU induced Elcon to bid on that project is the basis for the fraud alleged. EWU does not dispute the Study was intentionally concealed from Elcon and the other potential bidders. EWU also does not dispute misrepresenting the information it had relating to wells being drilled on campus. CP 864-865. At EWU's request, the Study included an in-depth analysis of how to develop additional groundwater capacity either from EWU's existing wells or a *new well on campus*, and also addressed the consolidation of the well rights. See e.g. CP 587; CP 610. The Study concluded that a well drilled 1,500' deep would be required to obtain adequate water from the

Grande Ronde aquifer if drilled anywhere on campus. CP 564-588; CP 316-356; CP 640-41. Since the *new* well was going to be drilled into the Grande Ronde, the Study and its conclusion, that any such well needed to be drilled to 1,500', was critical in assessing whether to bid and enter into the contract proposed by EWU. CP 624-636. Yet, EWU fraudulently concealed the Study.

Prior to bid, Elcon performed an "*independent investigation of the site or subsurface conditions*". CP 313. Elcon visited the site and requested all of the information EWU had relating to the Project, any other wells in the area, or the geology of wells in the area, "*including all exploratory work done by Owner...*" CP 864-865; CP 1113(emphasis added). EWU was legally obligated to supply the requested information which clearly contained important information about drilling a well on campus. Walla Walla Port Dist. v. Palmberg, 280 F.2d 237 (9<sup>th</sup> Cir. 1960); 1 Bruner and O'Connor on Construction Law, §3:25 (2008). However, EWU misrepresented *the only information* it possessed, and only provided Elcon information unrelated to the Grande Ronde Aquifer. The information it did provide to Elcon did not relate to the Grande Ronde Aquifer. Id. Later, EWU

again affirmatively misrepresented that no such studies existed! CP 673. EWU's fraudulent misconduct was done in order to induce bids, such as Elcon's bid. Elcon was effectively tricked into an adhesion contract and suffered significant damage it was otherwise prevented from recovering under the terms of EWU's contract.

EWU has been unable to explain why it designed two wells drilled to only 750' deep, despite the Study instructing that a new Grande Ronde well be drilled 1500' deep. CP 703-704; 740. Yet, the 750' depth was used as both the "*pre-design*" depth and the "*design*" depth. CP 651-655; 666-667. EWU represented the 750' depth to Elcon and other potential bidders as the scope of the Project. CP 678-680. The represented depth here was critical because as it increased, the drilling equipment required to drill deeper changes. Drilling at 1,500', as the Study indicated, requires special drilling equipment not commonly found in this region. See e.g. CP 713-714. Prior to the bid, EWU had been informed only a limited number of well drillers in the area were capable of drilling to 750'. CP 662. EWU knew the extremely deep well required special equipment. CP 713-714. Nonetheless, EWU specified the contractor would be required to drill

beyond 750' deep if water was not reached at that elevation. CP 306. EWU placed significant limitations on remedies in the event of claims based on the contract. CP 92-102. Of course, EWU secretly knew claims were likely since the Study indicated a well of 1,500' deep was required to obtain water.

Despite EWU's knowledge, the Study's conclusions were never discussed during the design of the Project. CP 713-714. Instead, EWU's Project specifications intentionally misrepresented to bidders that the scope of the drilling on the Project was two wells; both 750' deep. CP 678-680. EWU also expressly misrepresented *that the only geological information* available to the bidders was a well log and video for existing EWU wells located in a completely different aquifer. CP 864-865; CP 624-636. Additionally, in response to Elcon's request for all of the information EWU had relating to the Project, EWU misrepresented that the only information it had was an old well log and video from EWU's existing Well Number 2 and a video of the existing wells located in the Wanapum, an entirely different aquifer. CP 864-5.

Elcon provided a successful bid for the Project and proceeded. During the course of construction, Elcon learned of EWU's deception

with regard to the pre-existing comprehensive geological investigations and studies EWU possessed. CP 269. After four public records requests, Elcon finally received the Study and the Golder Report confirming EWU's pre-bid misrepresentations were blatantly and intentionally false. Supra. Nonetheless, EWU ordered Elcon to continue drilling beyond the 750' depth. When Elcon insisted upon payment for its increased costs of drilling, EWU terminated Elcon's contract "*for convenience*". CP 106. As required by the contract, EWU instructed Elcon to submit a pay request for the work performed prior to termination and Elcon submitted that pay request. CP 106-7. On October 22, 2004, EWU indicated it was "*converting*" the "*convenience*" termination into one for "*default*". CP 113-14.

Elcon filed suit based upon the contract, its statutory rights as a public works contractor and alleging torts. CP 3-33. EWU responded by moving to "*dismiss or stay*" the entire action based on the Economic Loss Rule ("*ELR*") and the arbitration provision in the contract. CP 34-41. The Court denied EWU's Motion to dismiss the tort claims. CP 221. The Court further ruled *that only a portion of the litigation would be stayed*, pending arbitration of the issue of whether money was

owed under the contract. Only the “*contract claims*” were stayed “*pending arbitration*”. CP 222. The parties submitted only the termination for convenience/termination for default dispute to Arbitration. The Court retained all remaining claims, including the statutory rights.

In Arbitration, Elcon’s position was that EWU breached its contract by refusing to make payments owed as a result of EWU’s termination for convenience. CP 927-932. In response, EWU claimed that due to its “*conversion*” to a termination for default, it did not owe any contract payments, but rather Elcon somehow owed EWU money. The Arbitrator confirmed Elcon was owed a contractual payment based upon the pay request. CP 249-50. The Award did not address interest or attorney fees. Id. The issue of statutory interest was not submitted to Arbitration by the Superior Court and has never been decided!

Elcon filed a motion with the Trial Court seeking statutory interest, or in the alternative, remand of the matter to the Arbitrator directing him to rule on the issue. CP 395-403. The Trial Court erroneously refused to decide the issue and also refused to remand it to the Arbitrator. CP 1019-1020. This was in spite of the fact the

Arbitrator had never been directed by the Court to decide the issue of statutory interest as part of the Arbitration. As a result, Elcon was never provided redress on the issue of statutory interest.

Following Arbitration, the litigation continued so the remaining issues could be resolved. Although the Trial Court had previously denied EWU's motion to dismiss, EWU filed a Motion for Summary Judgment, again seeking to dismiss Elcon's fraud claims based on the ELR. CP 359-376. The Court correctly denied EWU's Motion, finding the ELR did not apply. The Court also determined that genuine issues of material fact existed with regard to all of the elements of fraud. CP 1017-20. However, the Court erred by granting summary judgment on Elcon's Tortious Interference claim by finding there was no evidence of damages. CP 1018. Almost two years later, the matter was reassigned to a new Judge. At that point, EWU again re-filed its ELR motion, which had been twice denied. CP 1088. The new Judge erroneously ignored and changed the prior rulings, finding that the ELR barred claims for fraud. CP 1379-1384.

#### IV. ARGUMENT

##### A. EASTWOOD CONFIRMS THE TRIAL COURT ERRED BY RELYING ON ALEJANDRE AND DISMISSING ELCON'S TORT CLAIMS.

This Court recently confirmed the existence of a contract coupled with economic damages being sought does not require a tort action to be dismissed based on the economic loss rule. See Eastwood v. Horse Harbor Foundation, Inc., 170 Wash. 2d 380 (Wash., 2010). Instead, the appropriate analysis is whether the tort at issue arose from a duty independent of the contract (the "*Independent Duty Rule*"). Id. at 393. "*In sum, the economic loss rule does not bar recovery in tort when the defendant's alleged misconduct implicates a tort duty that arises independently of the terms of the contract.*" Id. The Court discussed numerous torts based upon which economic losses are recoverable even if they arise in the context of contractual relationships. Id. at 388. In other words, the Court identified torts where a legal duty exists regardless of the terms of the contract. These torts were the very type alleged by Elcon (Fraud and Tortious Interference) and which were wrongfully dismissed based on the ELR. Consequently, as

explained below, the Trial Court's summary dismissal and the Court of Appeals' decision should be reversed.

**B. EWU HAD AN INDEPENDENT DUTY NOT TO COMMIT FRAUD.**

No longer able to rely on the mere fact a contractual relationship existed, EWU has taken the remarkable position that because a contract resulted from its fraud that it was free to commit fraud with impunity. However, this ignores the fact that Washington has long recognized a legal duty exists not to commit fraud. Indeed, this Court pointed that out in the Eastwood opinion. Eastwood, 170 Wn. 2d at 388, citing American States Ins. Co. v. Symes of Silverdale, Inc., 150 Wn.2d 449, 452 (1960) and Obde v. Schlemeyer, 56 Wn.2d 449, 452 (1960). Furthermore, the ELR simply "*...does not bar claims of misrepresentation, non-economic damage, or claims arising independent of a contract. [ ] Thus, the economic loss rule does not bar ... claims of (1) fraud, ...*" Erickson v. Long Beach Mortg. Co., WL 830727, 5-6 (W.D. Wash., 2011), citing Eastwood. Indeed, it was already recognized that a claim of fraudulent concealment is not barred by the ELR. Alejandre v. Bull, 159 Wn.2d 674, 689 (2007) citing

Atherton Condo. Ass'n Bd. Of Dirs. V. Blume Dev. Co., 115 Wn.2d 506, 523-527 (1990)). “[U]nder Atherton, the Alejandres’ fraudulent concealment claim is not precluded by the Economic Loss Rule.” Id. (emphasis added). Thus, EWU had an independent duty not to commit fraud.

In addition, EWU’s duty to not commit Fraud was not abrogated by the fact it included an “*independent investigation*” clause in the Contract EWU’s fraud induced Elcon to enter into. It is well established that neither contractual obligations to conduct independent investigations nor disclaimer provisions destroy culpability stemming from misrepresentation and/or failure to state known facts.

*In our view the disclaimer provisions of the contract do not operate under the facts and circumstances of this case [failure to fully disclose relevant subsoil conditions] to prevent reliance by [contractor] on the implied representation of appellant that it had fully disclosed to [contractor] all relevant information and knowledge in its possession concerning subsoil conditions.*

Walla Walla Port Dist. v. Palmberg, 280 F.2d 237 (9th Cir., 1960).

Furthermore, “[r]equirements of fair dealing underlie government as well as private contracts.” U.S. v. Johnson, 153 F.2d 846, 849 (9<sup>th</sup> Cir. 1946) citing Hollerbach v. United States, 233 U.S. 165, 171 (1911).

Thus, by committing fraud, EWU breached an independent duty imposed by law, not by contract. Elcon's fraud claim is based on EWU's fraudulent misrepresentations inducing Elcon to submit a bid and to enter into an adhesion contract that limited the damages recoverable for the very issues arising directly EWU's Fraud. Hence, Elcon's fraud claim is outside EWU's contractual obligations; EWU's violation of the duties imposed by law. See 33 WA PRAC §8:5.

Washington case law has long held that a party fraudulently induced into a contract is able to recover damages. See Rathbone v. Frost, 9 Wash. 162 (1894) (“*We do not think the law should uphold men in their attempts to overreach others who are unsuspecting, and who rely upon the honor and integrity of those with whom they are dealing.*”) See also Forsyth v. Dow, 81 Wash.137 (1914) (Plaintiff could recover damages for deceit); Goodwin v. Palace Store Co., 164 Wash. 625 (1931); Coson v. Roehl, 63 Wn.2d 384, 388 (1963) (“*A contract, the making of which was induced by deceitful methods or crafty device, is nothing more than a scrap of paper...*”); and Leibergesell v. Evans, 93 Wn.2d 881 (1980).

Furthermore, EWU had a duty to disclose the information Elcon requested. *“Public agencies have an affirmative duty to disclose information to bidders that are within its own knowledge that is not readily available to bidders.”* 33 WA PRAC §8:5.

*One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated, ... (b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; ... (e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.*

The Restatement (Second) of Torts § 551; See also Scroggin v. Worthy, 51 Wash.2d 119, 123-24 (1957) (*“A man who deals with another in a business transaction has a right to rely upon representations of facts as the truth.”*); Lincoln v. Keene, 51 Wash.2d 171, 174-75 (1957); and Goodin v. Palace Store Co., 164 Wash. 625 (1931) (*“where inquiry is made, one owes a duty to answer truthfully.”*)

EWU, a public agency, had superior knowledge as to what would be required to obtain water from the Grand Ronde Aquifer on the EWU campus. CP 564-588. However, in 2002, when EWU

decided to drill two new campus wells into the Grand Ronde Aquifer, its design specified two 750' deep wells to be bid on a per foot unit price; a design that contravened what the Golder Report had disclosed. CP 564-588, 316-356, 640-641, 695-698, 671. Despite the fact that its design was in opposition to the Golder Report, EWU never disclosed this knowledge to any of the bidders. CP 864-865. Even more egregiously, when Elcon, as a part of its independent investigation of the site and subsurface conditions, requested all of the information EWU had relating to the Project, any other wells in the area, or the geology of wells in the area, "*including all exploratory work done by Owner...*" EWU did not disclose the Study. CP 864-865; CP 113.

Finally, the ELR does not apply in situations where the parties have never been in a position to negotiate the risks. See e.g. Neibarger v. Universal Cooperatives, Inc., 439 Mich. 512, 525, 486 N.W.2d 612 (1992). It is sound public policy that a party is not required to negotiate risks on the assumption the other party has committed fraud. In this case, because it was a public works project, Elcon was powerless to negotiate its risks. As a result, Elcon was required to submit a binding bid based on the terms established solely by EWU. See RCW 39.04 et.

seq. Therefore, Elcon had no ability to negotiate the terms of the contract to allocate the risk that EWU committed fraud in order to obtain bids. Consequently, the ELR should not be held to bar a claim of fraud that induces a public works contract.

Fraud in the inducement occurs “*when a misrepresentation leads another to enter into a transaction with a false impression of the risks, duties, or obligations involved.*” Black’s Law Dictionary 686 (8<sup>th</sup> ed. 2004). The case here is classic fraud in the inducement. As EWU admits, the Study concluded that any well drilled into the Grande Ronde aquifer needed to be 1,500’ deep. CP 578. EWU knew that regional drillers did not have the equipment necessary to drill 1,500’ deep. CP 713-714. EWU also knew only a handful of drillers in the area could even drill 750’ deep. CP 662. Consequently, EWU decided to intentionally conceal the Study from the new design engineer, from potential bidders, and from Elcon. CP 701, 704, 706-708 and 710. Incredibly, EWU dictated a design depth of 2 wells at 750’ and misrepresented to bidders the available Project information and the true scope of the Project. EWU also misrepresented to Elcon that it did not have information concerning a campus Grande Ronde

well. CP 864-865; CP 673. As a result, Elcon was fraudulently induced to enter into a unit price contract that severely limited its right to recover costs if ever there were a claim. CP 97-102.

Consequently, the Court of Appeals' decision here is inconsistent with Eastwood, established public policy and undermines the public good. Therefore, it should be reversed and Elcon given the opportunity to have its fraud claims decided on the merits.

C. EWU'S INTENTIONAL INTERFERENCE WITH ELCON'S SEPARATE BUSINESS EXPECTANCY.

Despite well established Washington law regarding the summary judgment standard, the Court of Appeals refused to review the Trial Court's granting the summary judgment with regard to EWU's intentional interference with a business relationship. It did so relying on the ELR, even though the interference allegations were not based on the contract at issue. In other words, the Court of Appeals held that as long as a contract exists, a party can commit any economic tort with impunity. As explained above, intentional interference with a business relationship is based on a duty that arises as a matter of law. Therefore, this ruling is contrary to Eastwood and should be reversed.

**D. PUBLIC WORKS CONTRACTORS ARE ENTITLED TO STATUTORY INTEREST.**

In this case, the Court of Appeals relied on the “*good faith*” exception found in the statute to justify Elcon being deprived of interest. RCW 39.76.010(1). However, that exception only applies if there is proper notice of the dispute. In this case, the record is clear that EWU never sent notice by certified mail, personal delivery or in accordance with the procedures in the contract. As a result, the Court of Appeals’ Opinion clearly goes beyond the express language of the statute.

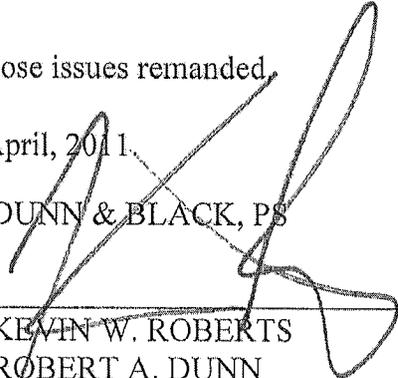
In addition, the Opinion confuses pre-judgment interest with statutory interest and fails to address the fact, that in this case, only a limited factual dispute was submitted to Arbitration. As a result, Westmark Properties, Inc. v. McGuire, 53 Wn.App. 400, 401 (1989) did not apply. Therefore, the decision should be reversed.

**VI. CONCLUSION**

Elcon respectfully requests that the summary dismissal of Elcon’s claims based on the Economic Loss Rule and the denial of

statutory interest be reversed and those issues remanded.

DATED this 4<sup>th</sup> day of April, 2011.

  
~~DUNN & BLACK, PS~~

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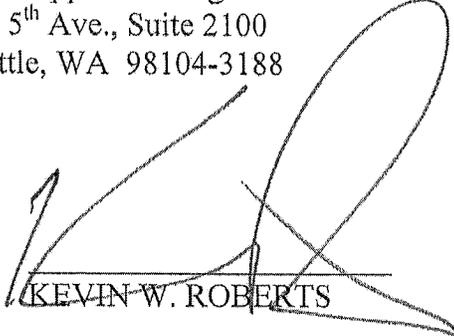
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**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that on the 4<sup>th</sup> day of April, 2011, I caused to be served a true and correct copy of the foregoing document to the following:

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KEVIN W. ROBERTS

**RCW 39.76.010**

**Interest on unpaid public contracts — Timely payment.**

(1) Except as provided in RCW 39.76.020, every state agency and unit of local government shall pay interest at the rate of one percent per month, but at least one dollar per month, on amounts due on written contracts for public works, personal services, goods and services, equipment, and travel, whenever the state agency or unit of local government fails to make timely payment.

(2) For purposes of this section, payment shall be timely if:

(a) A check or warrant is mailed or is available on the date specified for the amount specified in the applicable contract documents or, if no date is specified, within thirty days of receipt of a properly completed invoice or receipt of goods or services, whichever is later.

(b) For any amount which is required to be withheld under state or federal law, a check or warrant is mailed or is available in the proper amount on the date the amount may be released under the applicable law.

[1981 c 68 § 1.]

**Notes:**

Application -- 1992 c 223: See RCW 39.04.901.