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No. 63051-2-I

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

J.E. EDMONSON and NAOMI I. EDMONSON,

Plaintiffs,

v.

IVAN G. POPCHOI and VARVARA M. POPCHOI,

Respondents,

v.

CSABA KISS,

Appellant .

BRIEF OF APPELLANTS

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ORIGINAL

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I. INTRODUCTION

This case tests the outer limits of a seller's liability under a statutory warranty deed. The trial court ruled that a seller who accepts the buyer's tender of a statutory warranty deed claim may not simply settle the claim and pay the buyer's damages. The trial court further ruled that a buyer who obtains knowledge of a title defect may conceal that knowledge from the seller and nonetheless bring a deed warranty claim after closing. Washington law is sparse on both points, and this Court should affirm the right of sellers to settle tendered claims as well as the mutual duties of the parties to deal in good faith.

In 2006, Csaba Kiss sold a residential property to the Popchois. The Popchois intended to develop the property with a large home. Before purchasing the property, the Popchois had a survey performed, which revealed encroachments onto the property amounting to approximately 165 square feet. However, they did not inform Kiss of the encroachments. Instead, they closed and first raised the issue with Kiss when the neighbor predictably asserted a claim for adverse possession. At closing, the Popchois were aware of the encroachments, while Kiss was not.

The purchasers then tendered the defense of the neighbor's adverse possession claim to Kiss under the statutory warranty deed. Kiss promptly responded by accepting the tender, conditioned only on

“confirmation that the tender was made in accordance with RCW 64.04.030 and cases interpreting it.” Trial Exhibit 7. Specifically, Kiss wanted confirmation from the Popchois of his right to settle the adverse possession claim and then pay the Popchois damages for any breach of deed warranties.

The Popchois refused to give that confirmation. Instead, they insisted that Kiss was required to defend the adverse possession claim according to their instructions. When Kiss would not accept the tender on that basis, the Popchois defended the claim and lost on summary judgment.

This case was tried to King County Superior Court judge Bruce Hilyer. Judge Hilyer ruled that Kiss was entirely correct when he asserted that his liability was limited to the proportionate value of the 165 square feet lost through adverse possession. However, Judge Hilyer rejected Kiss’s assertion that the Popchois’ failure to disclose the encroachments violated the implied covenant of good faith or waived the warranty claim, and further held that Kiss had a duty under the statutory warranty deed to investigate the claim and present the seller with a justification for the settlement.

This Court should hold first that a seller who accepts the tender of the right to defend a claim may compromise or settle that claim in any

manner, provided that the seller shall be liable to the buyer for any resulting breach of a deed warranty. In other words, the Court should hold that a party who tenders the right to defend a deed warranty claim does not retain control over how the claim is defended.

This Court should also take this opportunity to reconsider or clarify its decision in *Foley v. Smith*, 14 Wn.App. 285, 539 P.2d 874 (1975). In *Foley*, this Court held that a buyer's prior knowledge of a title defect does not preclude a subsequent deed warranty claim. However, that decision was made in the context of a defect known to all parties, and did not consider waiver or whether a buyer has a duty to disclose known encroachments to the seller. The Court should hold that a buyer's concealed knowledge of an encroachment does breach the implied covenant of good faith and fair dealing, and that a buyer who completes a purchase without such disclosure waives any claim under the deed.

II. ASSIGNMENTS OF ERROR

1. The trial court erred when it ruled that a seller does not have the right to settle an adverse possession claim upon acceptance of a buyer's tender of the right to defend the claim.

2. The trial court erred when it ruled that a buyer's concealment of knowledge of an encroachment does not breach the implied covenant of good faith or waive a future deed warranty claim.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Does a seller who accepts a tender of the right to defend an adverse possession claim have the right to settle the claim and pay the buyer's damages? (Assignment of error 1)

2. If a seller does have such a right, is the seller required to first investigate the merits of the claim? (Assignment of error 1).

3. If a seller does have such a right, is the seller required to explain or justify the settlement to the buyer? (Assignment of error 1).

4. If the seller is required to explain or justify the settlement, what rights does the buyer have to reject or object to the settlement? (Assignment of error 1).

5. Does the implied covenant of good faith and fair dealing require a buyer to disclose encroachments discovered by the buyer before closing? (Assignment of error 2).

6. Is a deed warranty claim waived when the purchaser knows of a title defect before closing but does not inform the seller of the defect? (Assignment of error 2).

IV. FACTUAL BACKGROUND

The actual relevant facts in this action are few and undisputed. To the extent that any facts are contested, they are presented in a light most favorable to the Popchois as the prevailing party below.

In May 2006, Kiss sold a parcel of property in Bellevue to the Popchois for \$575,000. CP 159 at ¶ 1. The Popchois intended to construct a large home on the parcel for resale. CP 159 at ¶2.

Almost six months before closing, the Popchois had a survey of the property completed. CP 159-60 at ¶ 4. The survey plainly indicated that the neighbor's fence encroached onto the parcel. CP 160 at ¶ 5. Kiss was unaware of the survey or the encroachments. RP (01/08/09) at 27-28.

A boundary dispute with the neighbor are within three months after closing. Exhibit 1 (letter from neighbor's attorney). Kiss was informed of the dispute in an August 31, 2006 letter. Exhibit 2. On October 6, 2006, the Popchois' attorney wrote to Kiss demanding "whatever acts are necessary to cure your breach of warranty." Exhibit 4. On October 17, 2006, counsel for Kiss wrote back with a detailed response to the Popchois' position. Exhibit 5.

By March 20, 2007, the neighbors had filed an adverse possession claim. The Popchois forwarded the Summons and Complaint to counsel for Kiss with a "tender of defense and demand to hold my clients harmless and indemnify them from any loss or damages, including attorney fees, expenses and all other cost, arising out of this lawsuit." Exhibit 6.

On April 27, 2007, Kiss responded by noting that the tender did not meet all legal requirements, but nevertheless stated that:

Mr. Kiss conditionally accepts the tender of the right to defend the adverse possession action. This acceptance is conditional only on your confirmation that the tender was made in accordance with RCW 64.04.030 and cases interpreting it. I point this out because your letter referred to the tender of "the defense" to the action rather than a "right to defend" it. A tender of the defense alone could be interpreted as retaining the right to control the defense, whereas a tender of the right to defend includes the right to compromise or settle the claim. If your client has tendered the right to defend the claim, Mr. Kiss accepts that tender. If your client intends to retain rights to which he is not entitled under RCW 64.04.030, then that tender is rejected.

Exhibit 7 (copy attached as Appendix 1).

At about the same time, the Popchois retained a new attorney for the case. David Williams, who had made the tender, did nothing but forward the letter to the Popchois' new attorney, John Hathaway. RP (12-15/2008) at 219.

On May 2, 2007, Hathaway responded to Kiss's attempt to accept the tender of the defense. Exhibit 9. That letter rejects Kiss's position that he had the right to settle the adverse claim and pay the buyer's damages. *Id.* The record contains no further record of discussions regarding the tender from or to either party.

The Popchois continued to defend the adverse possession claim on the merits. On July 18, 2008, King County Superior Court Judge Steven Gonzalez granted summary judgment awarding the neighbor adverse possession. Exhibit 18.

The Popchois' deed warranty claims proceeded to trial. At trial, the Popchois' attorney who made the tender and received the response stated his position that Kiss could not unilaterally settle the claim under the tender that was made. RP (12-15-2008) at 230-31. He conformed this position in a lengthy series of questions from the court. RP (12-15-2008) at 240-47.

The trial court awarded the Popchois \$10,993.63 on a pro rata basis for the 165 square feet lost to adverse possession, along with prejudgment interest. CP 170 at ¶¶ 8-9. The trial court rejected all of the Popchois' other damage claims. CP 171-72 at ¶ 10.

With regard to the tender of the right to defend, the trial court ruled as a matter of law that sellers are required to defend against a tendered claim unless an investigation demonstrates that the buyer has no good faith defense to the claim.

5. The Court concludes that Csaba Kiss did not have the right, at the outset, to condition acceptance of the defense of the Popchois' title on the Popchois' agreement to convey the disputed land to the Edmonsons and accept a refund of the portion of the purchase price that they had paid for the disputed land. Csaba Kiss imposed these conditions shortly after the defense was tendered, without having investigated the merits of the adverse possession claim, solely based solely upon his determination that it would cost him less to convey the Popchois' land and refund part of the purchase price than to defend their title. Although it turned out that the Edmonsons' adverse possession claim prevailed on summary judgment, this court cannot judge the duty to

defend base solely on the outcome of the claim. The merits of the Edmonsons' claim was by no means obvious at the outset of the lawsuit. The fence extended along slightly less than half of the boundary line, while grass covered both lots for the remainder of the properties. The parties were unaware of what evidence the Edmonsons would submit to prove the elements of adverse possession and to defeat the defenses of acquiescence and the like.

6. The seller is not entitled to insist that the buyer waive the right to defend the claim and agree to convey the property to the claimant unless the seller has conducted a reasonable investigation, informally and through formal discovery and, from the information so gained, reasonably concluded that the buyer has no good faith defense to the adverse possession claim. To justify abandoning any defense, the seller would have to present the buyer with information demonstrating the lack of any defense to the claim. Csaba Kiss submitted no evidence that he or his attorneys conducted such a thorough investigation, or formal discovery of the Edmonsons' claim. Mr. Kiss submitted no evidence that he or his attorneys ever presented facts to the Popchois demonstrating that there was no defense to the Edmonsons' adverse possession claim. The only evidence before the Court is Csaba Kiss's testimony that he conditioned his "acceptance" of the tender of defense upon the Popchois agreement to abandon their right to a defense and to accept a partial refund of their purchase price solely because that course of action was less expensive for Csaba Kiss than defending the Popchois' title. Csaba Kiss's refusal to defend the Popchois' title unless they agreed to these conditions breached his covenant to defend their title against the Edmonsons adverse possession claim,

CP 169-70 at ¶¶ 5-6. Based on this ruling, the trial court concluded that Kiss had wrongfully denied the tender of the claim and therefore was liable for the Popchois' attorney fees. CP 170 at ¶ 7.

The trial court rejected all arguments concerning the Popchois' prior knowledge of and silence about the encroachments without elaboration. CP 172 at ¶¶ 11-13.

V. LEGAL ANALYSIS

A. Standard of Review.

Because this appeal raises purely legal questions based on an undisputed factual record, review is *de novo*. *In re Estate of Kissinger*, 166 Wn.2d 120, 125, 206 P.3d 665, 667 (2009) (“We also interpret questions of law *de novo*.”).

B. Tender of a Deed Warranty Claim Includes the Right to Compromise the Claim and Pay Damages.

There is admittedly little direct law on the rights of parties under the tender of a deed warranty claim. The warranty deed statute itself makes no reference to tendering claims or other enforcement mechanisms. RCW 64.04.030.

By far, the leading case is this Court's decision in *Mastro v. Kumakichi Corp.*, 90 Wn.App. 157, 951 P.2d 817, 821 (1998), but that case addresses the requirements for a formal tender, not the rights of the parties after a tender is accepted. *Mastro* does, however, provide some useful guidance.

Mastro holds that to invoke the duty to defend, the buyer must tender “the right to defend the action.” *Mastro* 90 Wn.App. at 165. It borrowed this phrase from “vouching in,” a common law means of tendering a claim and seeking indemnity. *Id.* (citing *Dixon v. Fiat-Roosevelt Motors, Inc.*, 8 Wn.App. 689, 509 P.2d 86 (1973)). In this way, *Mastro* recognizes that the common law of tendering claims applied to deed warranties. That law explicitly requires the buyer to tender the *right* to defend the claim, rather than the duty to defend the claim at the buyer’s direction.

Only one Washington case appears to have addressed the meaning of “the right to defend.” In *Petersen-Gonzales v. Garcia*, 120 Wn.App. 624, 86 P.3d 210, 213 (2004), a insured disputed her uninsured motorist carrier’s decision to participate in the trial of her personal injury claim. Her policy provided that the UIM carrier had the “right to defend,” but did not define that term. *Id.* at 630-31. She argued that this right to defend did not include the right to participate in her trial against her wishes. *Id.*

The Court of Appeals disagreed. First, the Court held that the “right to defend” had a plain meaning that included the right to participate at trial. Moreover, the Court reasoned that a UIM carrier breaches no duty to the insured by participating because the UIM carrier “stands in the

shoes” of the insured and therefore has an interest in minimizing the recovery. *Id.* at 633-34.

That reasoning applies with equal force to this case. The seller under a statutory warranty deed is not required to prevent any breach of the covenants at any cost. Rather, the Washington courts have always recognized that the remedy for a breach of a deed warranty is an award of damages. *Brown v. Carpenter*, 99 Wash. 227, 229, 169 P. 331, 332 (1917); see *Mellor v. Chamberlin*, 100 Wn.2d 643, 645, 673 P.2d 610, 611 (1983).

The seller has the right to defend an adverse possession claim as a prerequisite to the buyer’s recovery of attorney fees because the buyer is only entitled to an award of damages if a breach cannot be cured. A buyer with a minor encroachment as in this case may well prefer for the seller to spend far more than the amount of damages in a futile effort to defend against the claim, but the law simply does not allow buyers to impose that burden on sellers.

If the trial court’s reasoning were accepted, it would know no bounds. It is hard to imagine any boundary dispute in which a party could not formulate a “good faith defense.” A seller who concluded that a dispute over a minor encroachment would, as was the case here, cost three times as much to defend as was at stake, could be forced by the buyer to

take the case to trial. And after a loss, the same logic would require an appeal. No Washington decision has remotely endorsed such an interpretation of deed warranties, and this Court should hold that a tender of the right to defend a claim necessarily includes the right to compromise or settle the claim and pay the damages to which the buyer is entitled.

C. Bad Faith Is A Defense to a Deed Warranty Claim.

It remains the law in Washington that parties to a contract have a duty of good faith to each other. *Liebergesell v. Evans*, 93 Wn.2d 881, 892-95, 613 P.2d 1170, 1177 (1980). In the context of real estate transactions, that duty is most commonly identified as the duty to disclose material facts. *McRae v. Bolstad*, 101 Wn.2d 161, 167, 676 P.2d 496, 500 (1984).

The trial court understandably read *Foley v. Smith*, 14 Wn.App. 285, 539 P.2d 874 (1975) as an absolute rule that a buyer's deed warranty claim is never barred by prior knowledge of a title defect, but the holding in the case is much more limited, and the decision did not address a buyer's concealment of the defect.

Foley was the third published decision in a longstanding dispute over a parcel of property that the Foleys sold twice over a period of four months in 1965, first to the Kreger Brothers and then to the Smiths. *Hudesman v. Foley* 73 Wn.2d 880, 881-84, 441 P.2d 532 (1968). The

Smiths were informed of the Kreger Brothers agreement before they purchased the property, but told that the agreement had expired. *Id.* at 884. The Kreger Brothers experienced financial difficulties and assigned their rights to Hudesman. *Id.* The Foleys closed with the Smiths, and Hudesman brought an action for specific performance. *Id.* at 880-81. The trial court granted summary judgment to Hudesman. *Id.* The Supreme Court reversed, holding that material factual issues existed whether the Kreger Brothers agreement had expired and whether the Smiths were *bona fide* purchasers for value. *Id.* at 891.

On remand, the case was tried and again resulted in a judgment in favor of Hudesman as assignee of the Kreger Brothers. *Hudesman v. Foley*, 4 Wn.App. 230, 231, 480 P.2d 534, 535-36 (1971). The Court of Appeals affirmed, holding that the agreement had not expired and that the Smiths were not *bona fide* purchasers for value because they knew of the prior agreement.

The case was not over however. In 1965, the Foleys had closed with the Smiths, accepting their payment and delivering a statutory warranty deed. *Foley*, 14 Wn.App. at 287-88. With the funds paid by Hudesman, the Foleys repaid the Smiths and were left with \$20,000. *Id.* The Smiths demanded that amount as well, and another lawsuit followed.

Id. After trial, the remaining amount was awarded to the Smiths as damages for breach of deed warranties. *Id.*

The Foleys appealed, but the Smiths did not file a response brief in the Court of Appeals. *Id.* at 289-90. Accordingly, the Court of Appeals stated that it would “limit its review to determining if appellant has made out a prima facie case for error and if appellant has, will reverse and determine the nature of the remand.” *Id.* at 290.

The Court did address the Foleys’ argument that a deed warranty claim was barred by the prior holding that the Smiths were not *bona fide* purchasers for value. In four short paragraphs, the Court rejected this argument

CONCLUSION. Knowledge on the part of the grantees of an outstanding potentially superior claim to the land to which they obtained a deed does not bar their claim for breaches of the covenants of warranty and quiet enjoyment in their deed when they are later evicted from the property by judicial action.

Mrs. Foley cites us to the prior litigation commenced by the prior purchaser wherein it was held that as to the prior purchaser ‘(t)he Smiths were not bona fide purchasers for value.’ *Hudesman v. Foley*, 4 Wash.App. 230, 233, 480 P.2d 534, 537 (1971). She argues this as res judicata in the present case and as establishing that the trial court erred in concluding that the Smiths could still be bona fide purchasers as to the Foleys in the present case.

Whether or not the Smiths were bona fide purchasers for value when they obtained the deed from the Foleys is not determinative of the present case. The fact that the Smiths,

as grantees under the deed, had knowledge at the time of the execution of the conveyance of an allegedly outstanding superior claim of title, does not bar their right to recover for breaches of the covenant arising from their subsequent eviction. *Fagan v. Walters*, 115 Wash. 454, 457, 197 P. 635 (1921); 20 Am.Jur.2d *Covenants, Conditions, & Restrictions* § 54 (1965); 21 C.J.S. *Covenants* § 38 (1940).

Such covenants warrant against known as well as unknown defects, and grantees with knowledge of an encumbrance have the right to rely on the covenants in the deed for their protection. *Fagan v. Walters, supra*. The purpose of the covenant is protection against defects, and to hold that grantees can be protected only against unknown defects would rob the covenant of much of its value and destroy the force of its language. *Williams v. Hewitt*, 57 Wash. 62, 65, 106 P. 496 (1910).

Foley, 14 Wn.App. at 292-93.

Over the following 34 years, only two cases have cited *Foley* for this proposition, and those contain no analysis. *Mastro v. Kumakichi Corp.*, 90 Wn.App. 157, 162, 951 P.2d 817, 820 (1998) (“A warranty deed covenants against both known and unknown title defects. *See Foley v. Smith*, 14 Wash.App. 285, 292, 539 P.2d 874 (1975).”); *Sackman Orchards v. Mountain View Orchards*, 56 Wn.App. 705, 710, 784 P.2d 1308, 1311 (1990) (“Covenants of warranty are held to warrant against *known* as well as unknown defects and encumbrances. *Cf. Fagan v. Walters*, 115 Wash. 454, 457, 197 P. 635 (1921); *Foley v. Smith*, 14 Wash.App. 285, 292, 539 P.2d 874 (1975) (construing effect of warranty of title given under a statutory warranty deed).”).

Other cases have left open the question whether prior knowledge of a breach may waive the deed warranty in that respect. *See Hebb v. Severson*, 32 Wn.2d 159, 170-71, 201 P.2d 156, 161 (1948); *Brown v. Herman*, 75 Wn.2d 816, 821, 454 P.2d 212, 216 (1969). More recently, in *Shinn v. Thrust IV, Inc.*, 56 Wn.App. 827, 786 P.2d 285 (1990), Division One considered the circumstances under which a buyer may waive the right to marketable title.

A waiver is an intentional relinquishment of a known right. *In re Bellanich*, 43 Wash.App. 345, 717 P.2d 307 (1986). Thrust clearly could have intended to relinquish or waive its right, under the agreement, to marketable title regardless of whether it knew of existing violations. However, Thrust's addendum "remov[ing] all contingencies referenced in the Purchase and Sales Agreement and Exhibit A of said agreement" does not amount to a waiver of its right to marketable title.

As Thrust points out, the Purchase and Sale agreement only refers to "contingencies" in two provisions: one provision states that the note is "due upon removal of contingencies described on Exhibit A" and the other says "the sale shall be closed ... on or before 90 days following removal of contingencies described in Exhibit A." (Emphasis added.) The contingencies described in Exhibit A pertain only to financing terms and acceptable plans and specifications sufficient for issuance of a building permit. The Exhibit also states that the Purchase and Sale agreement is null and void if Thrust "has not removed and/or waived the contingencies described above by written notice ... on or before September 1, 1983." (Emphasis added.) Reading the Purchase and Sale agreement and Exhibit A together, the only reasonable construction of the documents is that the "contingencies" referred to in the addendum removing contingencies are those listed in Exhibit A. The contingencies do not include marketable title or other terms and conditions of the Purchase and Sale agreement. Therefore, the title defect or marketability requirement was not expressly waived by the addendum.

The next question is whether Thrust waived the marketability provision by its conduct. A waiver by conduct occurs if the actions of the person against whom waiver is claimed are inconsistent with any intention other than waiver. *Birkeland v. Corbett*, 51 Wash.2d 554, 320 P.2d 635 (1958).

The Shinns argue that Thrust waived the marketability requirement because prior to execution of the earnest money agreement for Lot 2, Thrust (1) developed Lot 1 without raising any concerns about title encumbrances, (2) sold Lot 1 without disclosing title problems, and (3) listed Lot 2 for sale after having knowledge of the claimed violations or defects. Thrust's conduct as to Lot 1 does not appear to be consistent only with an intent to waive the marketability requirement for Lot 2. There is no evidence that Thrust knew of any title problems when it executed the partnership agreement as to Lot 1. If it did have such knowledge, it may have decided that it would take a risk on any title problems as to Lot 1, but decided that it would not take those same risks as to Lot 2. Likewise, while the listing of Lot 2 for sale may be consistent with an intent to waive defects, it is also consistent with an intent to generate interest in the property so that a quick sale could be accomplished as soon as the marketability requirement was satisfied and the sale between the Shinns and Thrust closed. The marketability requirement was not waived by conduct.

Id. at 843-844.

Although waiver was not proven under the facts of *Shinn*, the facts here are very different. The Popchois knew about the encroachment very shortly after the agreement was executed and long before any work began on the house. They concealed that knowledge from Kiss and prevented him from addressing it before closing or terminating the transaction. Although most cases concern questions of a seller's good faith, the law is mutual and reciprocal. This Court should hold that under the undisputed

circumstances of this case, the Popchois waived their deed warranty claim for the known encroachment.

VI. CONCLUSION

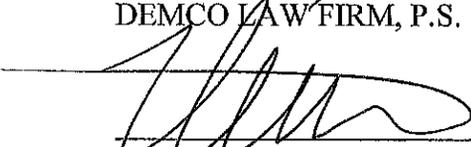
The Court should rule that the Popchois did not effectively tender the defense of the adverse possession claim because they refused to permit Kiss to settle the claim and pay damages. The award of attorney fees therefore should be reversed.

The Court should further rule that claims for deed warranties may be waived or barred by a buyer's concealed knowledge and bad faith conduct. The Court therefore should reverse the judgment for damages in favor of the Popchois.

The Court should reverse the trial court's ruling and remand for an award of taxable costs to Kiss.

DATED this 27th day of July, 2009.

DEMCO LAW FIRM, P.S.


Matthew F. Davis, WSBA No. 20939
Attorneys for Csaba Kiss

DECLARATION OF SERVICE

I, Ellen M. Krachunis, am over the age of 18 years, and based on my personal knowledge, state as follows:

On July 27, 2009, I caused true and correct copies of the documents listed below to be served on the persons listed below by depositing them, properly addressed and postage pre-paid, in the U.S. Mail to

Court of Appeals Division I
One Union Square
600 University Street
Seattle, WA 98101-4170

John Hathaway
4600 Columbia Center
701 Fifth Avenue
Seattle, WA 98104

— BRIEF OF APPELLANTS

Declarant is a resident of the State of Washington and over the age of eighteen (18) years. I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Dated this 27 day of July, 2009 at Seattle, Washington.


Ellen Krachunis

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STATE OF WASHINGTON
2009 JUL 29 AM 10:45