

67036-1

67036-1

No. 67036-1-I

COURT OF APPEALS
DIVISION I
OF THE STATE OF WASHINGTON

CAPITOL SPECIALTY INSURANCE CORPORATION,

Appellant,

v.

YUAN ZHANG,

Respondent.

APPEAL FROM KING COUNTY SUPERIOR COURT
Honorable Julie Spector, Judge

BRIEF OF RESPONDENT

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I. NATURE OF THE CASE

This is a case about construction defects at the Lake City Park Place Apartments here in Seattle. Ms. Zhang as the Sole member of Lake City Way Place Condominiums LLC, originally sued Hawk Construction, LLC (“Hawk”), general contractor, for breach of contract. Hawk in turn sued Ready Construction, LLC (“Ready”), a subcontractor, for breach of contract and indemnity.

Just prior to trial, Ms. Zhang entered into a settlement and stipulated judgment with a covenant not to execute with Hawk. Under the terms of the settlement, Ms. Zhang was assigned all of Hawk’s claims against Ready and its insurers.

After taking the assignment, as assignee of Hawk, Ms. Zhang also settled with Ready. Again, the parties agreed to a stipulated judgment with a covenant not to execute, and assignment of claims, which included claims against Ready’s insurers.

Capitol Specialty Insurance Corporation (“Capitol”) insured both Hawk and Ready for this Project and provided a defense to both of them in Ms. Zhang’s action.

Ultimately, Ms. Zhang moved the trial court for a reasonableness hearing on the amount of the Hawk and Ready settlements. Capitol was allowed to intervene in both instances.

The trial court held both settlements were reasonable. Ms. Zhang respectfully requests this Court affirm.

II. ISSUES PRESENTED

1. Did the trial court abuse its discretion by finding the settlement between Ms. Zhang and Hawk reasonable according to the Chaussee/Glover factors? No.
2. Did the trial court abuse its discretion by finding the settlement between Ms. Zhang, as assignee of Hawk, and Ready reasonable according to the Chaussee/Glover factors? No.

III. STATEMENT OF THE CASE

Respondent is Ms. Yuan Zhang, the sole member of Lake City Way Place Condominiums LLC, which owns the Lake City Park Place Apartments. The building contains 39 units and is located in North Seattle.

Prior to purchasing Lake City, Ms. Zhang had it inspected by Mr. Jeff Samdal of Pioli Engineers. The inspection by Pioli/Mr. Samdal was visual only. CP 292-93. According to the Pioli Report, the Lake City building was in fair condition and only a few repairs away from being in good condition. CP 312, ¶ 4. Confident she could take the necessary steps to upgrade the building, Ms. Zhang purchased it.

After purchasing Lake City, Ms. Zhang approached Hawk with the repair job. Prior to committing to Ms. Zhang's proposal, Hawk inspected the property with one of the subcontractors it planned to bring on board

for the repairs, Ready. CP 742, pp. 15-17, lns. 24- 1.

Feeling confident it could complete the job with Ready after doing the inspection, on October 15, 2007, Hawk and Ms. Zhang entered into a contract. The scope of work in the contract included the following:

1. Remove all existing vinyl siding and damaged building components underneath it;
2. Apply new hardiplank¹ siding;
3. Remove and replace all damaged decking materials;
4. Apply new waterproof decking materials; and
5. Perform all work in accordance with the Washington State Building Code.²

CP 830. The contract terms also provided Hawk was responsible for the supervision, means, methods, techniques, sequencing and procedure for carrying out all of the work. CP 832, ¶ 9.

On October 25, 2007, Hawk subcontracted with Ready to execute the siding and deck repair portion of the work included in Hawk's contract with Ms. Zhang. CP 760.

Phase 1 of the work at Lake City commenced in October of 2007.³

Hawk did not perform any actual construction in Phase 1; all of the work

¹ "Hardiplank" is a cementitious siding product.

² The "State Building Code" is the same as the "International Building Code," which applies to this Project by incorporation under RCW 19.27.031.

³ The repair work at Lake City is best understood in Phases. Phase 1 started in October 2007 and ran through roughly March of 2008. Phase 2 started in March of 2008 and ended approximately October of 2008.

in Phase 1 was performed by Ready. CP 753, p. 58 lns. 1-4.⁴ Ready, however, only showed up to work periodically in Phase 1, leaving the building unfinished and unprotected for several weeks at a time. CP 747, p. 33 Lns. 6-18.

Despite its long absences from the job site, at no time did Ready or Hawk approach Ms. Zhang to request payment for weather protection. While it may have been Ms. Zhang's obligation to pay for weather protection under the terms of the contract, it was Hawk's responsibility to request and install it if necessary. CP 832, ¶ 9; see also CP 756, p. 70 lns. 5-13. Even more specifically, under the terms of Hawk's contract with Ms. Zhang, it was Hawk's responsibility to ensure all of the work it performed or contracted to perform was protected. CP 833-34, ¶ 15. Hawk was, in addition, aware that Ms. Zhang had very little or no construction experience and was completely relying on Hawk to make any decisions affecting the work. CP 742, p. 13-14 lns. 9-2.

As a consequence of the missing weather protection and lack of finished work, Ms. Zhang started getting complaints from her tenants about water leaks in their units. Several of her tenants explained that water was penetrating their units from areas where Ready left the building incomplete and/or unprotected. CP 747, pp. 22, 33 lns. 2-22, 6-18.

Later in Phase 1, in or around February or March of 2008, Ms. Zhang noticed/it was brought to her attention that in addition to the leaks,

⁴ Please note that neither Hawk nor Ready speak English well. A translator was necessary for Hawk's/Mr. Kwang Park's deposition.

the siding Ready put on the building was falling off. The original exterior assembly at Lake City - from the outer most layer moving inward – was a layer of vinyl siding, followed by layers of foam wall board, building paper, gypsum wall board, and OSB sheathing. Rather than remove the entire wall assembly and make any necessary repairs, Ready only took off the first layer of vinyl siding and replaced it. CP 754 p. 62 lns. 16-19. Aside from the fact that Ready was not carrying out the scope of work agreed to by the parties, the nails Ready used were not long enough to securely fasten the new siding to the building and therefore, the new siding started falling off. CP 753, p. 59 lns. 1-4.

Because of the problems in Phase 1, and given that Ms. Zhang had to leave the country for a few weeks, she hired the services of a third-party contractor, Steelhead Construction, to review the work performed in Phase 1. Steelhead confirmed with Hawk that the siding was not installed correctly (i.e. that it never should have been put on directly over the foamboard) and that its work on the decks did not meet code. CP 754, pp. 32, 62 lns. 12-16, 6-15.

After Steelhead brought these issues to Hawk's attention, Hawk and Ready began to strip the new siding off the building, marking the start of what is referred to in the pleadings on file as Phase 2 of the repairs.

When Ms. Zhang returned from her vacation, Hawk told her about the damage and explained it would correct Ready's work and repair any associated damage as originally agreed to in their contract.

During the initial siding take-off in Phase 2, Hawk and Ready noticed several areas where water had penetrated the building behind the siding and had caused damage to the sheathing layers beneath it. CP 755, pp. 66-67 lns. 24-2.

Around this same time Hawk told Ms. Zhang about the problems in Phase 1, she asked Mr. Rohn Amegatcher to help her with Lake City. Mr. Amegatcher was assisting Ms. Zhang as a construction manager on some of her other Projects and therefore, he agreed to assist her. Ms. Zhang asked Mr. Amegatcher to come on board at Lake City to confirm Hawk and Ready showed up on a consistent basis. She did not hire him to supervise Hawk's work. CP 755, pp. 67-68 lns. 18-4.

After Mr. Amegatcher agreed to assist at Lake City, and in light of Hawk's promise to repair all of Ready's Phase 1 work, Ms. Zhang did not commission Steelhead for any additional services. Steelhead did not supervise Hawk or Ready in Phase 2. CP 748, pp. 38 lns. 10-12.

Like Steelhead, Mr. Amegatcher was not employed at Lake City for very long. After just a few visits, Hawk told Ms. Zhang to relieve Mr. Amegatcher of his job there, which she did, believing Hawk would fix the mistakes made in Phase 1. CP 755, p. 68 lns. 1-4. Mr. Amegatcher did not supervise Hawk or Ready's work in Phase 2; he played only a limited role in the repairs at the outset of Phase 2. CP 748, p. 38 lns. 10-12.

Hawk and Ready continued to work on Lake City until October of 2008. When they left, parts of the building and decks were unfinished and

several areas of the building were still left exposed to elements. CP 746, p. 32 lns. 2-5.

Once Ms. Zhang realized Hawk was not coming back to finish the job, she hired a consultant to review the work done by Hawk and Ready. Indeed, the work was done wrong for the second time. The consultant noted while Hawk and Ready did strip off the entire exterior cladding assembly in Phase 2, they did not assemble it back together properly. The “weather resistive barrier”⁵ was not installed in a weather-proof manner, and the gypsum wall board was omitted entirely, taking away the building’s one hour fire rating. CP 731, p. 25 lns. 10-21. Further, the deck work was incomplete and any deck repairs made up to that point did not meet code. CP 183-86, 201-06, 221-250.

Finally, the consultant told Ms. Zhang that she needed to make temporary repairs to stop additional water intrusion into the building. Ms. Zhang had the recommended temporary repairs made right away.

On or about April 6, 2009, Ms. Zhang filed a lawsuit against Hawk for breach of contract. Hawk raised a limited number of affirmative defenses in its answer and filed a third-party complaint against Ready for breach of contract and indemnity.

On July 2, 2010, the Court entered an order finding Hawk breached its contract with Ms. Zhang. CP 271. Specifically, the Court held

⁵ A “Weather Resistive Barrier” also commonly referred to as “WRB” or “building paper” is a layer of impervious paper, applied behind siding in a shiplap fashion to water proof the exterior wall cavity. It is a building’s last line of defense against water penetration into the structural parts of a building. CP 184, ¶¶s 10-12.

that Hawk breached its contract by failing to remove and replace the siding and decks in compliance with the terms of the contract. Id.

After an unsuccessful mediation, Ms. Zhang filed her trial brief requesting \$2,128,606.72 in damages from Hawk. CP 278.

On or about November 19, 2010, Ms. Zhang settled with Hawk by way of a confession of judgment and assignment of Hawk's claims against its carriers and Ready. The total amount of the settlement was \$1,858,873, or a more than a quarter of a million dollars less than what Ms. Zhang was seeking at trial. CP 426-427.

Shortly after taking an assignment of Hawk's claims against Ready, Ms. Zhang as assignee of Hawk, settled with Ready. Like Ms. Zhang's settlement with Hawk, Hawk's settlement with Ready included a confession of judgment and covenant not to execute. The total amount of the settlement was \$522,900. CP 597.

The procedural facts or facts describing the filing of the reasonableness motions in Capitol's brief accurately reflect what happened after the Ready settlement. However, it should be clarified that the reason the trial court entered the orders granting the Hawk and Ready's reasonableness motions *nunc pro tunc* was the consequence of a clerical error; it was nothing more significant than that. See e.g. CP 1031-1034

Finally, along with filing this appeal, Capitol filed a declaratory action in Federal Court to determine its policy obligations to Hawk and

Ready. Ms. Zhang in her individual capacity and as assignee of Hawk, counter-claimed for breach of contract and insurer bad faith.⁶

IV. ARGUMENT

A. The Trial Court's Reasonableness Determination Should be Reviewed for Abuse of Discretion.

A trial court's reasonableness determination is reviewed for abuse of discretion. Werlinger v. Warner, 126 Wn. App. 342, 349, 109 P.3d 22 (2005). An abuse of discretion occurs when a decision rests on untenable grounds or is manifestly unreasonable. Mayer v. Sto Indus., Inc., 156 Wash.2d 677, 684, 132 P.3d 115 (2006). A trial court's decision is manifestly unreasonable if it is outside the range of acceptable choices, given the facts and the applicable legal standard; it is based on untenable grounds if the factual findings are unsupported by the record; and it is based on untenable reasons if it is based on an incorrect standard or the facts do not meet the requirements of the correct standard. Kitsap County v. Smith, 143 Wash.App. 893, 180 P.3d 834 (2008).

Capitol's argument that the standard of review is *de novo* since the trial court committed an error of law by not making findings of fact (i.e. there was no substantial evidence for the trial court's reasonableness determination) is not supported by Green v. City of Wenatchee, 148 Wn. App. 351, 199 P.3d 1029 (2009). In Green, one of the issues was whether the trial court prevented the intervening

⁶ With the exception of a few additional details, the facts included herein were stipulated to by Ms. Zhang, Hawk, and Ready. CP 508-514; CP 552-558.

insurer/appellant from arguing the merits of its insured's liability defenses (primarily its statute of limitation defense) at a reasonableness hearing. Prior to the reasonableness hearing, the trial court entered stipulated findings of fact and conclusions of law prepared by the insured and claimant. The Court held that even though the findings and conclusions of law were stipulated to, the insurer was not collaterally estopped from asserting the insured's liability defenses at the reasonableness hearing. In its reasoning, the Court explained the insurer did not waive its insured's defenses as they had not been judicially addressed prior to the settlement. Further, the issue of whether the *insurer was collaterally estopped from raising the insured's defenses was a question of law* and therefore, the *de novo* standard of review applied.

Capitol did not make an assignment of error on collateral estoppel. And even assuming it had, Green is different from this case for three reasons: 1) there is no evidence Capitol was prevented from raising any of its insured's defenses; 2) its defenses were judicially addressed; and 3) there was no total defense (i.e. statute of limitations defense) to Ms Zhang's claim like the defendant had in Green.

Also, the fact that the trial judge did not enter findings of fact with regard to each of the Chaussee/Glover factors is not a basis to change the applicable standard of review. See Water's Edge Homeowner's Ass'n v. Water's Edge Associates, 152 Wn. App. 572,

216 P.3d 1110 (2009); citing Martin v. Johnson, 141 Wn. App 611, 620, 170 P.3d 1198 (2007).

Since the trial court had authority to conduct the reasonableness hearing, and because Green does not apply, the trial court's reasonableness determination for the settlements with Hawk and Ready should be reviewed for an abuse of discretion.

B. A brief history of the Chaussee/Glover factors and why they apply here.

Under RCW 4.22.060, the trial court may hold a hearing to determine the reasonableness of a settlement. In Glover v. Tacoma Hosp., 98 Wn.2d 708, 658 P.2d 1230 (1983) the Supreme Court adopted nine factors relevant to the determination. They are the follows:

1. the releasing person's damages;
2. the merits of the releasing person's liability theory;
3. the merits of the released person's defense theory;
4. the released person's relative fault;
5. the risks and expenses of continued litigation;
6. the released person's ability to pay;
7. any evidence of bad faith, collusion, or fraud;
8. the extent of the releasing person's investigation and preparation of the case; and
9. the interest of the parties not being released.

These same factors were later adopted to determine the reasonableness of consent judgments with covenants not to execute. See Besel v. Viking Ins. Co., 146 Wn.2d 730, 49 P.3d 887 (2002); see also Chaussee v. Maryland Casualty Co., 60 Wn. App. 504, 803 P.2d 1339 (1991).

In 2007, the Court of Appeals adopted the same approach to

settlements with a covenant not to execute in breach of contract condominium construction defect cases. Villas at Harbour Point Owner Ass'n v. Mutual of Enumclaw Ins. Co., 137 Wn. App. 751, 154 P.3d 950 (2007), review denied, 163 Wn.2d 1020 (2008). Although the factors applied in Glover, Chaussee, and Besel are derived from tort law and therefore, implicate issues of comparative fault, in Heights at Issaquah Ridge Owners Ass'n v. Derus Wakefield I, LLC, 145 Wash.App. 698, 703, 187 P.3d 306 (2008), the Court of Appeals held the same Chaussee/Glover factors apply in a breach of contract case, but should instead be reasoned against the settlement in the context of whether the settlement is a product of bad faith, collusion, or fraud.

Here, the trial court did not err resolving the issue of reasonableness according to the Chaussee/Glover factors, or finding in light of the applicable factors, the settlements between Ms. Zhang and Hawk, and Hawk and Ready were reasonable. As explained by the Court in the Villas opinion, the trial court has authority to conduct a reasonableness hearing in a breach of contract construction defect case following the entry of a consent judgment and covenant not to sue under RCW 4.22.060. 137 Wn. App. at 751.

Further, the trial court did not abuse its discretion as Capitol was unable to show the settlement was a product of bad faith, collusion, or fraud using any of the nine Chaussee/Glover factors. Heights, supra.

C. The trial court did not abuse its discretion by finding the settlement between Ms. Zhang and Hawk was reasonable.

The settlement between Ms. Zhang and Hawk was based on the following calculations:

Construction: \$ 1,224,471

Lost Rents: \$ 107,880.00

Cost: \$ 43,537

Attorney Fees: \$ 495,319.68

Subtotal: \$ 1,871,207.68

<10 percent deduction/187,120.77>

Total: \$1,684,086.91

The \$1,224,471 agreed to by the parties for construction repairs was within 10 percent of their respective repair costs. The trial court took almost a \$140,000 deduction from the original amount claimed for lost rents, which was originally set at \$250,680. Ms. Zhang agrees with the trial court's reduction in lost rents. Attorney fees were calculated at a rate of 36 percent since the case was settled on the eve of trial. Costs and expert fees were included as they were recoverable under the prevailing party clause in the parties' contract.

Finally, Ms. Zhang took a flat 10 percent reduction off the total settlement to acknowledge the risks inherent in litigation and to acknowledge the settlement was negotiated in good faith at arm's length. See e.g. Heights, 145 Wash.App. at 706-7 (a reduction of seventeen and one-half percent on Plaintiff's cost of repair was enough

to show the settlement agreement was reasonable and not a product of fraud or collusion.)

1. The trial court did not abuse its discretion by finding Ms. Zhang's damages were substantial.

- a) Ms. Zhang and Hawk's experts both agree her damages were substantial.

Ms. Zhang was substantially damaged by Hawk's defective work. None of the siding or deck work by Hawk or Ready was done properly. See Appellant's Brief, p. 5 ("the first phase of the work, which all parties agree was defective...") In Phase 1, Ready did more damage than it did good. Not only did it fail to mount the siding correctly to the building, its failure to come to work consistently and/or leave the building unprotected allowed water to penetrate into and behind the sheathing, in some instances even into units. It was Hawk's job to supervise Ready and consequently, Hawk was liable to Ms. Zhang for any damage caused by Ready's work.

Hawk and Ready's work in Phase 2 was defective as well. If installed in a proper ship-lap fashion and free of gaps and voids, building paper forms an impenetrable weather resistive layer in a building's exterior cladding assembly. Hawk's failure to install the building paper according to code left the sheathing layers and other underlying structural components open to continuous water intrusion.

With the exception of some replacement quantities for windows and sliding glass doors, Ms. Zhang and Hawk's experts, Mr. Martin

Flores of Dimensional Building Consultants and Mr. Tom Harader of JRP Engineering, respectively, agreed to the same scope of repair for the building. CP 726, p. 7 lns. 14-23.

Since Capitol could not rely on Mr. Harader to dispute Ms. Zhang's scope of repair, it hired its own expert for the reasonableness hearing. Without ever attending a single intrusive investigation, or even seeing Lake City in person, Mr. Mark Lawless testified that 80 percent of the damage at the building pre-existed the repair work. CP 802. He alleged, moreover, that all of the damage was caused by a vapor drive problem and was not a consequence of exterior water penetration. CP 802-03.

The court rejected Mr. Lawless's testimony for at least one of several reasons. First, he had never visited the Project. CP 800. Second, Mr. Lawless's entire presumption about the source of the damage was implausible because the building did have a vapor barrier. CP 929, ¶¶s 2, 3. Third, there were obvious signs of exterior water intrusion, which Hawk's expert acknowledged. CP 727, p. 9 lns. 4-16. Finally, assuming it was even possible, Hawk did not ask its expert to try and allocate damages. CP 735, pp. 43-44 lns. 24-6; see also Brewer v. Fibreboard Corp., 127 Wn.2d 512, 541, 901 P.2d 297 (1995) (Court's determine the reasonableness of a settlement "at the time the parties enter into it.")

Capitol also relied heavily on the Pioli Report to argue Ms.

Zhang was aware of pre-existing damage⁷ behind the siding. Mr. Samdal, however, testified that the report was never intended to establish any of his presumptions about unseen damage as fact. CP 293.

Notwithstanding Mr. Samdal's testimony, Ms. Zhang was aware of the possibility that there was damage behind the siding. That is why Ms. Zhang contracted with Hawk on a time and material basis to repair damage. CP 837. The fact she agreed to pay for damage repairs does not make her damages less substantial. Ms. Zhang was entitled to recover the cost to repair Lake City, minus the deductions explained above, because the work called out by the parties' experts was to repair damage caused by Hawk and Ready's work.

The trial court considered Mr. Lawless' testimony and Capitol's arguments, but did not ultimately find them convincing where both Ms. Zhang and Hawk's experts agreed on the scope of repair.

- b. Ms. Zhang's repair bid includes only work that all of the experts agree is necessary.

Capitol's argument that Ms. Zhang's damages are not substantial because the settlement amount includes work outside of her contract with Hawk is not supported by the record. Ms. Zhang is not calling for a wholesale roof repair as Capitol tries to make it appear. Instead, the roof repairs are limited to areas where the roof transitions to the siding or where Hawk and/or Ready attempted repairs in Phases 1 and 2. C 842, ¶

⁷ The insurance policy with Capitol allegedly contains an exclusion for preexisting damages.

(e); CP 853, ¶ (e). Also, both Mr. Flores and Mr. Harader agree this selective roof repair is necessary. Id.

Both Mr. Flores and Mr. Harader also agree that door pans must be installed to bring Lake City into compliance with the current building code. CP 844, ¶ (p), CP 855 (p). Lastly, Mr. Flores and Mr. Harader agree the rim joists and headers⁸ for the decks need to be repaired because of the failure to install the deck coating/weatherproofing properly. CP 846 ¶ (g); CP 858 ¶ (g).

c. Ms. Zhang is not asking for upgrades.

There is nothing substantial about the alleged upgrades to the trim, railings, or second layer of building paper that make the settlement with Hawk unreasonable. Although it is possible that some expert may argue two layers of building paper is an upgrade, Mr. Reichlin, Ms. Zhang's cost estimator, testified the total cost for the controversial second layer of paper was just \$1,000. CP 828, lns. 17-20.

The railings Mr. Flores specified are the cheapest available. Id. at 14-15.

For the trim, Mr. Reichlin priced cedar, as Whitewood, albeit a slightly cheaper product, is notorious in the construction community for not being able to stand up to the Pacific Northwest climate.

Any future repairs at Lake City need to be done to the existing code. CP 840, ¶ 13, CP 851, ¶ 13. The only upgrade that *may* not be a

⁸ The "rim joists" and "headers" are parts of the structural beams that hold up the cantilevered/elevated decks at Lake City.

part of this requirement is the \$1,000 for an additional layer of building paper.

- d. It is not Ms. Zhang's responsibility to shoulder the cost of damage and any associated loss caused by Hawk and Ready's defective work.

Hawk testified that Ms. Zhang gave it everything it needed to perform successfully at Lake City. CP 742, p. 15 lns. 12-17. Ms. Zhang was relying on Hawk to direct and supervise all of the work, and it was, moreover, Hawk's responsibility under its contract with Ms. Zhang to prevent any loss or damage to the property. CP 833-34, ¶ 15.

Ms. Zhang should not be charged with paying for the damages caused by Hawk and Ready, nor should she be forced to pay the cost of any loss caused by their work. She did not impede the repair process nor play any part in Hawk's failure to perform. CP 743, p. 19 lns. 9-11.

- e. Ms. Zhang's damages are not excessive in light of the facts.

The trial court did not abuse its discretion in finding the cost of repair agreed to by Ms. Zhang and Hawk was reasonable. Capitol argued/argues that the cost of repair was somewhere in the middle of the parties' repair bids. Ultimately, that is exactly where the parties' negotiations landed them. Ms. Zhang's total cost of repair is \$1,224,471.74, which includes permitting fees, Architect and Engineering fees, and water penetration testing fees mandated by RCW 64.55. CP 772. Hawk's cost of repair is \$887,693, but that does not

include RCW 64.55 testing, which Mr. Harader testified should have been added. CP 727, pp. 11-12 Ins. 25-13. RCW 64.55 testing would add another \$100,000 approximately to Hawk's cost of repair bid, making it \$987,693, and leaving the parties only a little more than \$200,000 apart. CP 772. After factoring in Ms. Zhang's general settlement reduction of 10 percent, the parties were, as Capitol argues they should be, somewhere right in the middle of their experts two bids.

- f. The cost of repair is the legally correct measure of damages, not diminution in value.

Washington courts ordinarily base contract damages on the injured party's expectation interest. Eastlake v. Hess, 102 Wn.2d 30, 46, 686 P.2d 465 (1984). An injured party's expectation interest in a breach of contract action for construction defects is the cost to remedy the defects unless the cost is clearly disproportionate to the probable loss in value of the subject property. Panorama Village Homeowners Ass'n v. Golden Rule Roofing, Inc. 102 Wash.App. 422, 427, 10 P.3d 417 (2000) review denied, 142 Wn.2d 1018 (2001). As described in Panorama, it was Capitol's burden to show the loss in property value at Lake City was the correct measure of damages and not the cost to repair the defects.

Once the injured party has established the cost to remedy the defects, the contractor [breaching party] bears the burden of challenging this evidence in order to reduce the award, including providing the trial court with evidence to support an alternative award [loss of value].

Id. at 428. Capitol did not meet its burden to show an alternative award was proper.

Aside from that, Capitol did not submit any evidence that demonstrated the proper measure of Ms. Zhang's damages was in fact the loss in value of the property like in Water's Edge, 152 Wash. App. 587.

In Water's Edge, the plaintiff Homeowners Association sued the previous property owners and property manager for construction defects in a condominium complex in Clark County. The defendants and HOA entered into a settlement, with a stipulated judgment and covenant not to execute. At a subsequent reasonableness hearing, the trial court held the settlement was not reasonable under the Chaussee/Glover factors. The HOA appealed the decision. This Court reviewed several of the trial court's findings and conclusions with regard to the Chaussee/Glover factors on appeal. This Court affirmed the trial court for several reasons; one of them was the HOA's failure to use the proper measure of damages to calculate its settlement. In opposition to the HOA's proposed cost of repair damages, defendant submitted evidence to the trial court that all of the condominium units in Water's Edge sold for more than the original sales price, thus shifting the burden of proof back to the HOA to show that damages were not limited to the loss in value at the property, which it could not do. 52 Wn. App. at 587.

This case is distinguishable from Water's Edge. Here, Hawk

never submitted any evidence that loss in value of Lake City was the proper measure of damages prior to Capitol's intervening at the reasonableness hearings and Hawk never plead loss or diminution in value as an affirmative defense either. See CR 8(c). Even then, Capitol's only evidence was Mr. Lawless's presumption that 80 percent of the damage at Lake City pre-existed Hawk and Ready's damage and was the consequence of a missing vapor barrier. CP 802, 929 at ¶¶s 2, 3.

As explained above, the trial court did not find Mr. Lawless's testimony compelling where Mr. Flores, who was much more familiar with the project, testified there was a vapor barrier at Lake City and where both he and Mr. Harader testified repairs were necessary because of Hawk and Ready's defective work. CP 485, ¶ 4; CP 727, p. 9 lns. 4-16.

- g. The rent concession is reasonable and not outside the range of meaningful choices.

A 12 month concession is reasonable, and the trial court did not abuse its discretion by awarding Ms. Zhang 12 months of loss rents.

The work at Lake City concluded in October of 2008. The parties settled in November of 2010. For approximately 12 months Ms. Zhang's renters endured ongoing construction that in several cases, caused water to leak into their units. Unit 103 was so damaged that it was rendered completely uninhabitable. CP 491, ¶ 3. For three years now, several of the sliding glass doors at the Project have been boarded

off because the decks are unsafe.

On top of everything else, repairs are on hold for the appeal process and Capitol's declaratory action.

Ms. Zhang was entitled to loss rents under her contract with Hawk. CP 831. She originally calculated 30 months taking into account the length of work, a year of litigation, and six months for repairs. CP 491. In consideration of Capitol's argument that no risk was factored into her thirty month calculation – excluding the general 10 percent reduction taken by her – Ms. Zhang agreed to 12 months of lost rents instead.

In the end, the livability and marketability of units in Lake City could be impacted for a total of four years or more. A 12 month concession is more than reasonable taking into account the length of this entire process and the effect the process has had on securing existing and future rentals. CP 491, ¶ 2.

- h. The trial court properly awarded Ms. Zhang her attorney and expert fees given the applicable facts and legal standards.

The trial court did not abuse its discretion in finding a 36 percent contingency fee was reasonable. Trial courts may award attorney fees when authorized by contract, statute, or a recognized ground in equity. Cosmopolitan Eng'g Goup, Inc. v. Ondeo Degremont, Inc., 159 Wash.2d 292, 297, 149 P.3d 666 (2006). Here the contract provides, “the prevailing party shall be entitled to recovery of attorney fees and

costs.” In addition, attorney fees, which take into consideration a contingent fee agreement, are entirely consistent with Washington law. Allard v. First Interstate Bank of Washington, 112 Wn. 2d 145, 150, 768 P.2d 998, 773 P.2d 420 (1989).

Capitol was unable to show that a 36 percent contingency rate was unreasonable for this case or inconsistent with the standard rate in Seattle. This case settled on the eve of trial. Ms. Zhang and Hawk settled on November 19, 2010, and trial was set to commence on November 22, 2010. At the time of settlement, Ms. Zhang was in full blown trial preparation.

Even further still, counsel for Ms. Zhang had a significant amount of billable hours on this file to justify its contingency fee. CP 1009; CP 944-1007.

The trial court also properly awarded Ms. Zhang expert fees under Panorama, 144 Wn.2d at 142. In Panorama, the petitioner homeowners association was awarded expert fees which helped show covered damages in its action against the defendant’s insurer. The Supreme Court said, “[t]he phrase ‘reasonable attorney fees’ in and of itself supports an award [of expert fees] not limited by ‘costs’ as described by RCW 4.84.010.”

2. Ms. Zhang’s case had merit where Hawk’s defense theory lacked it.

Ms. Zhang had a strong case against Hawk. An order was

entered on summary judgment in favor of Ms. Zhang confirming Hawk breached its contract. CP 268-272. Also, the experts for both parties agreed the work at Lake City did not meet code. CP 182-250; CP 727, pp. 9, 25 lns. 9-13, 12-21.

On the other hand, Hawk had only two defense theories: (1) Ms. Zhang withheld information from Hawk; and (2) the defective work and damage was Mr. Amegatcher and/or Steelhead's fault.⁹

The theory that Ms. Zhang did not provide Hawk with pertinent information is without foundation. Mr. Samdal testified that anyone relying on his report to argue he knew of any preexisting siding damage was clearly in error. CP 292-93. Also, any damage to the decks was visible and Hawk reviewed the Project with Ready before commencing work. CP 742, pp. 15-17, lns. 24- 1. Because the report was purely speculative about damage behind the siding, Ms. Zhang contracted with Hawk to make repairs to damage on a time and material basis. CP 837. It was not the case as Capitol tries to make it appear that Hawk was forced into the contract with Ms. Zhang.

Hawk, moreover, understood extensive deck repairs were necessary at Lake City. Capitol's attempt to draw distinction between Ms. Zhang's use of the word "replace" in her deposition and "repair" in her contract with Hawk when referring to the deck work is not

⁹ Hawk plead only one applicable affirmative defense, which was the damages could have been caused in whole or in part by a third-party. The other three defenses Hawk plead were failure to state a claim, statute of limitations, and failure to comply with RCW 64.50 and RCW 64.55, none of which had any merit.

significant. Hawk knew the decks needed extensive repairs as it contracted with Ready to “demolish, repair and repaint them.” CP 761.

With regard to Hawk’s second defense theory, neither Steelhead nor Mr. Amegatcher managed or approved Hawk’s work. Steelhead, if anything, disapproved of Hawk/Ready’s work and was not retained during Phase 1 or Phase 2 of the repairs. CP 748, p. 38 lns. 10-12. Mr. Amegatcher, like Steelhead, was not present for Phase 1 of the repairs, and was terminated in the early part of Phase 2 at the request of Hawk. CP 755, p. 68 lns. 1-4. Even further, Mr. Amegatcher was not hired to oversee or approve Hawk’s construction work, only to verify it was coming to work on a consistent basis. CP 748, p. 38 lns. 10-12.

3. The trial court did not need to consider Ready’s fault at Hawk’s reasonableness hearing.

The trial court does not typically consider parties’ relative fault to determine the reasonableness of a settlement arising out of a breach of contract claim. Heights, 145 Wash.App. at 703; see also Water’s Edge, 152 Wn. App. at 587. To the extent this factor is relevant, however, the trial court correctly reasoned that it was Hawk’s responsibility to supervise and direct all of the work at Lake City and to repair the building to code. CP 268-272; CP 832.

Capitol’s argument that Ms. Zhang should have assigned a value to the claim it was gaining against Ready as part of the Hawk settlement is not compelling because it presumes at least two things: (1) Ready had

agreed to settle with Ms. Zhang before the settlement was reached with Hawk; and (2) Ms. Zhang had all information necessary to value the settlement claim (e.g. a summary of Hawk's attorney fees and its costs). Neither presumption is correct.

4. The risk and expenses of continued litigation were great for both parties.

Like Capitol's argument that Ms. Zhang should have considered the relative fault of Ready in the settlement with Hawk is logically flawed, so is the argument that Ms. Zhang received a judgment in excess of her trial damages. Ms. Zhang in her individual capacity and as the sole member of Lake City Way Place Condominiums LLC settled with Hawk. Ms. Zhang as assignee of Hawk settled with Ready. As an assignee, Ms. Zhang only stepped into the shoes of Hawk. Estate of Jordan v. Hartford Accident & Indem. Co., 120 Wash.2d 490, 495, 844 P.2d 403 (1993) (An assignee of a contract "steps into the shoes of the assignor, and has all of the rights of the assignor.") She did not substitute in Hawk's place. See e.g. CR 25. The trial court correctly reasoned that each of the settlements between the parties should be compartmentalized, and not combined.

5. Hawk's ability to pay is not limited by the timing of the lawsuit or its dissolution.

The trial court considered Hawk's ability to pay, and properly rejected Capitol's arguments that the suit was not filed timely, and that Hawk's inactive status was a shield to personal liability.

The fact that Hawk was inactive at the time it was sued is not momentous here. A limited liability company may be sued, for example, up to three years after dissolution. RCW 25.15.303. Two years if the LLC is administratively dissolved. Id.; see also Chadwick Farms Owners Ass'n v. FHC LLC, 166. Wash.2d 178, 207 P.3d 1251 (2009).¹⁰ As Capitol points out, Hawk was sued just four months after becoming inactive, meaning it was capable of suing or being sued under the Limited Liability Company Act.

Capitol made the exact same argument at the hearing that it makes here with regard to the affect of dissolution and bankruptcy being the same. The trial court properly recognized, however, they are not. Here, Hawk's principal could have been personally liable to Ms. Zhang if Hawk did not defend itself. As explained in Chadwick, under the Limited Liability Act, the failure to wind-up an LLC, including making reasonable provision for paying any claims and obligations known to the company, even if they are unmatured, conditional, or contingent could result in personal liability. Id. at 197.

In comparison, in Werlinger, this Court affirmed the trial court's determination that the settlement was unreasonable because the respondent was *fully discharged from any personal liability* in

¹⁰ The issue in Chadwick was if a "cancelled" versus "dissolved" LLC has the capacity to sue or be sued. The Supreme Court held that an LLC ceases to exist upon cancellation. An LLC is cancelled automatically two years after administrative dissolution, but that does not bar an LLC from winding-up sooner than two years and filing a certificate of cancellation sooner. In this case, however, there is no evidence that Hawk was cancelled prior to the commencement of the suit.

bankruptcy. 126 Wn. App at 351-52.

The trial court did not abuse its discretion by rejecting Capitol's argument that suing a bankrupt entity is tantamount to suing a dissolved one.

6. There is no evidence of bad faith, fraud, or collusion, and certainly no evidence the parties ventured to set-up a bad faith claim.

Since Ms. Zhang met her burden to show the settlement with Hawk was reasonable, it was Capitol's burden to show it was a product of bad faith, collusion, or fraud. Besel, 146 Wn. 2d at 739. Capitol failed to meet its burden because this case is not Water's Edge and the judgment represents the liability of Hawk.

As described earlier, in Water's Edge, the plaintiff HOA entered into a settlement and stipulated judgment with a covenant not to execute with defendant declarant for construction defects at a condominium complex in Clark County. At a subsequent reasonableness hearing, three of the insurers for defendant intervened and successfully argued the amount of the stipulated judgment was unreasonable. Although the trial court rejected the reasonableness of the settlement under many of the Chaussee/Glover factors, the trial court found the collaborative efforts of the HOA and coverage counsel for the declarant to negotiate a settlement and tee up a bad faith claim against the insurers particularly troubling. Id. at 595-96. For example, HOA's counsel sent a written letter to coverage counsel that was critical of defense counsel, HOA's

counsel communicated with coverage counsel several other times behind defense counsel's back, and also developed a kick-back scheme for an unmerited malpractice claim against defense counsel. All of these collaborative efforts left the insured without any incentive to challenge the terms of the settlement and simply maximized the amount of the settlement. Id.

The questionable behavior of the parties in Water's Edge cannot, under any stretch of the imagination, be compared with the settlement reached in this case. Most importantly, there was never any questionable communication between Ms. Zhang's counsel and coverage counsel. But still beyond that, Ms. Zhang and Hawk settled on repair damages that were approximately 10 percent apart according to their experts. Hawk's expert determined Lake City was damaged as a consequence of Hawk and/or Ready's work, and the damages were not manufactured for purposes of a bad faith claim. The settlement included fees and consequential damages/loss rents because they were supported by parties' contract and applicable law. There were no negotiations between Ms. Zhang and Hawk until after mediation with Capitol failed, and leading up to that point, Ms. Zhang had obtained an order in her favor finding Hawk in breach of contract.

Further, Capitol's suggestion that the judgments against Hawk and Ready should be viewed together is flawed in theory. As explained above, the Hawk and Ready judgments must be compartmentalized.

Ms. Zhang is pursuing her own interests as the sole member of Lake City Way Place Condominiums, LLC in the judgment against Hawk, but she is only pursuing the judgment against Ready in the shoes of Hawk. In other words, she did not cut Hawk out of the picture; she only took its place.

There was no collusion or fraud with Hawk's insurance application either. The relevant parts of the application relied on by Capitol were actually filled out by its agent, McFall General Agency, Inc. CP 812-816. This suit was not pending until after Hawk submitted its insurance application so there was no secret understanding between it and Ms. Zhang to defraud Capitol.¹¹ Id.

Capitol's allegation that the settlement is a product of fraud or collusion begins and ends with the mere raising of the specter of collusion the Supreme Court in Besel explained is part of every settlement that includes a covenant not to execute. 146 Wash.2d at 738; citing Evans v. Cont'l Cas. Co., 40 Wash.2d 614, 628, 245 P.2d 470 (1952). Ms. Zhang was able to overcome her burden and show the trial court that her settlement with Hawk was at arm's length and not the product of bad faith, fraud, or collusion.

7. The trial court considered Capitol's interests.

Capitol had an unfettered right to intervene at the reasonableness

¹¹ Ms. Zhang only addresses the insurance application issue to the extent it may be applicable to the reasonableness hearings. The possible coverage issues the insurance application affects should be left to resolve in Capitol's declaratory action.

hearings. Ms. Zhang agreed to Capitol's intervention at the reasonableness hearings, only submitting that its intervention should be consistent with the decision in the The Heights, which again said in breach of contract construction defect cases the Chaussee/Glover factors are relevant only to show bad faith, collusion, or fraud. The trial court denied Ms. Zhang's request, letting Capitol intervene without any restriction whatsoever. CP 564.

In addition, Hawk was not in bankruptcy when it was sued, it was inactive. As explained above, the legal effect on personal liability in bankruptcy and dissolution are distinct. The trial court did not err by rejecting Capitol's attempt to syllogize Werlinger with the facts and circumstances of this case.

D. The trial court did not abuse its discretion by holding the settlement between Ms. Zhang, as assignee of Hawk, and Ready was reasonable.

Ms. Zhang, as assignee of Hawk, shall be referred to simply as "Hawk" in the superseding sections.

Ready performed all of the construction in Phase 1 and also worked alongside Hawk on Phase 2. Because of the overlap in its work in the different phases, and because Hawk and Ready shared employees, it was basically impossible to segregate the amount of damage its work caused in Phase 1 from Phase 2. Mr. Mike Caniglia, who Ready hired as an expert, testified at his deposition that he could not even think of a way to segregate the damages between Hawk and Ready's work. CP

716, p. 57 lns. 9-17

Without the ability to allocate or segregate damages, Hawk and Ready agreed a reasonable alternative for the total settlement amount was Ms. Zhang's out-of-pocket expenses.¹² Ms. Zhang's out-of-pocket expenses proved reasonable as all of Ready's work was defective (e.g. because of Ready's botched siding job in Phase 1, for Phase 2, all new siding had to be purchased. CP 97, ¶ 3; CP 747, p. 33 lns. 19-23) and Ready was obligated to defend, indemnify, and hold harmless Hawk from any damages caused by its work. CP 25-26, ¶ 5.

The value of the settlement between Hawk and Ready was calculated as follows:

Construction costs for Phase 1/Ready's Work: \$380,546.89

Attorney fees and costs: \$ 142,354.72

- Preg O'Donnell Gillet
 - Fees \$75,137.50
 - Costs \$21,043.25
- Casey & Skoglund
 - Fees \$45,132.47

Total: \$522,901.61

1. The releasing party/Hawk's damages were substantial.

The Hawk and Ready settlement was not designed to award Ms.

¹² To make things even more complicated, Hawk's payment records for Lake City were seized by the IRS. CP 751, p. 49 lns. 2-5.

Zhang her out-of-pocket expenses as Capitol alleges. Without the option of allocating damages on the table, the parties used what Ms. Zhang paid for all of the work done over the course of Phase 1 and 2 as a *yardstick* to measure Hawk's damages.

Ready was paid more than its contract price for its defective work and Hawk paid Ready almost \$30,000 out of its own pocket. CP 753, p. 60 lns. 8-13.

Further, Ready's defective work significantly damaged Lake City. Mr. Caniglia agreed with Mr. Flores and Mr. Harader that to repair Lake City, the siding and decks need to be stripped down to the framing, any damage to the framing must be repaired, and the deck and entire wall assembly needs to be put back together in a code compliant manner. CP 713, pp. 47-48 lns 25-10.

2. The trial court properly awarded Hawk attorney fees and costs.

Hawk was entitled to fees, expenses, and costs as part of the agreement with Ready for both its breach of contract and indemnity claims. CP 762, ¶¶ 3 and ¶ 6.

Capitol defended Hawk under a reservation of rights. Mindful of this fact, at the trial court Hawk argued that fees and costs should be included in the judgment as long as Capitol was seeking reimbursement of them as part of its action for declaratory judgment. CP 1015-16, Section D. Without any indication Capitol was foregoing reimbursement

of its defense fees and costs from Hawk, the trial court properly held it was reasonable to include them in the settlement. CP 1034.

3. Merits of Ready's Defense Theory.

Ready's defense was weak; even Capitol admits that all of the work Ready performed in Phase 1 was defective. Appellant's Brief, p. 5.

Capitol's construction supervisor defense theory was weak as both Steelhead and Mr. Amegatcher played extremely limited roles in Lake City. Neither Steelhead nor Mr. Amegatcher had any involvement in Phase 1, and Mr. Amegatcher was onsite only briefly in Phase 2 before being terminated at Hawk's request.

And also explained above, Ready accompanied Hawk on the initial review of the building and never raised any issue with its scope of work. Capitol's argument that Ms. Zhang withheld information is without merit where Ready had an opportunity to inspect Lake City before contracting with Hawk.

4. The risks and expenses of continued litigation and Ready's ability to pay.

Capitol argues in support of the risks of continued litigation Chaussee/Glover factor, as it did for Hawk, that Ready had no ability to pay a judgment because it was inactive. But as explained by Ms. Zhang in regard to Hawk, an inactive corporation is not immune from being sued. RCW 25.15.303. Like Hawk, Ready could have been sued until November 30, 2010, or at least two years after it failed to renew its

license with the Secretary of State on November 30, 2008. If Ready would have taken the approach recommended by Capitol, its principal would have faced personal liability for any judgment entered against Ready. Chadwick, 166. Wash.2d at 197.

As far as Capitol's argument that settling did not remove the risk and uncertainty of trial because it was fronting defense costs, please see the discussion above at Section 2 on page 31 pointing out Capitol was defending Ready under a reservation of rights.

5. Hawk's settlement with Ready is not a product of bad faith, collusion, or fraud.

The reason why Hawk's damages were calculated the way they were is set forth above in great detail, as are the reasons why this case is not Water's Edge.

The argument that Ready misrepresented the contents of its insurance application fails for the same reasons the argument fails in the context of Ms. Zhang's settlement with Hawk. Capitol's agent, McFall, filled out the questionable parts of the application and there was no suit against Ready at the time it submitted its insurance application. CP 817-821.

6. Ready had an unfettered right to intervene and all of its arguments were considered by the trial court.

The trial court gave Capitol an unfettered right to intervene at the reasonableness hearing. It even denied Ms. Zhang's motion to limit

Capitol's intervention as described in The Heights.

Hawk was not in bankruptcy when it was sued. Again, the Werlinger case is easily distinguishable from this case since Hawk was only inactive at the time of suit, and not in bankruptcy.

CONCLUSION

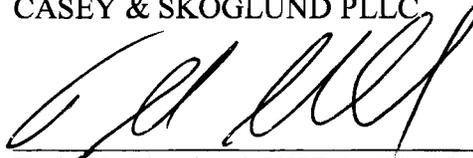
Both the Hawk and Ready settlements are within the range of acceptable choices given the facts of this case. The trial court's decision with regard to each of the settlements is based on an extensive record of facts and legal argument in support/opposition of every single one of the Chaussee/Glover factors.

Capitol's appellate brief is only a combined version of the briefs it submitted to the trial court as an intervenor at Hawk and Ready's reasonableness hearings. Rather than point to a specific error in law or certain material facts that are not supported in the record, Capitol is asking this Court to reconsider the entire record based on the incorrect presumption that a reasonableness determination is reviewed *de novo*.

A trial court's decision on the reasonableness of a settlement should be reviewed for abuse of discretion. Applying the applicable standard of review, the trial court did not err in finding the Hawk and Ready settlements to be reasonable, and therefore, this Court should affirm the trial court.

RESPECTFULLY SUBMITTED this ___ day of November, 2011

CASEY & SKOGLUND PLLC

A handwritten signature in black ink, appearing to read 'T. Skoglund', written over a horizontal line.

Todd K. Skoglund, WSBA #30403

Adil A. Siddiki, WSBA #37492

Attorneys for Respondent

CERTIFICATE OF SERVICE

I, Todd K. Skoglund, declare as follows:

1) I am a citizen of the United States and a resident of the state of Washington. I am over the age of 18 and not a party to the within entitled case. I am a partner at the law firm of Casey & Skoglund PLLC, whose address is 114 West McGraw Street, Seattle, WA, 98119.

2) By the end of the business day on November 28th, 2011, I caused to be mailed to counsel of record at the addresses, postage prepaid, and in the manner described below, the following documents:

• **BRIEF OF RESPONDENT**

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Counsel for Appellant: Capitol Specialty Insurance Corporation

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

DATED this 14th day of December, 2011.



Todd K. Skoglund
Attorney for Respondent

ORIGINAL