

COURT OF APPEALS DIV I
STATE OF WASHINGTON
2012 JUN 5 PM 2: 20

No. 67371-8-I

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

AFRIQUE V. NERO, individually and as Guardian of C.A. NERO, a
minor,

Plaintiff/Appellant,

vs.

VIRGINIA MASON MEDICAL CENTER, a Washington non-profit
corporation; CYRUS CRYST, M.D. and JANE DOE CRYST, and the
marital community composed thereof; and JOHN DOES 1-10,

Defendants/Respondents/Cross-Appellants.

**RESPONDENTS' AMENDED REPLY BRIEF IN SUPPORT OF
CROSS APPEAL**

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I. INTRODUCTION AND SUMMARY OF ARGUMENT

In this alleged medical negligence case, Ms. Nero sought a jury award at trial that included approximately \$360,000 in past and future earnings, along with future medical care ranging from \$3.1 to \$7.4 million. None of these amounts is *de minimus*.

Given the tax-conscious nature of this country and Washington state and the public's general lack of knowledge about the statutory exclusion of taxes on personal injury awards, the trial court should allow a jury instruction to that effect. Dr. Cryst's proposed jury instruction is not complicated, confusing, or burdensome. It does not require tax tables, additional computations, references to IRS regulations, or introduction of additional evidence.

The instruction proposed by Respondent Dr. Cryst, which the trial court declined to submit to the jury, states as follows:

Any award to plaintiffs will not be subject to federal income tax and therefore you should not add or subtract for such taxes in fixing the amount of any award.

(CP 455)

As the Ninth Circuit Court held, the "benefits of informing the jury of the true tax consequences are so clear, and the burden in terms of time and the possibility of confusion so minimal, that we believe the balance is

overwhelmingly in favor of giving such an instruction.” *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 297 (9th Cir. 1975).

Accordingly, if the Court is inclined to reverse and remand Ms. Nero’s case to the trial court, then Dr. Cryst respectfully requests that the Court likewise reverse the trial court’s decision to not submit his proposed jury instruction regarding taxation.

II. STATEMENT OF FACTS

A. Ms. Nero’s Past and Future Earnings Totaled \$360,000.

Ms. Nero’s expert economist, Robert Moss, reviewed Ms. Nero’s tax returns, wage earning history, and a report of her vocational planner and life care planner. (CP 1243) At trial, he offered his economic calculations with respect to her loss of earnings to date, as well as future earnings. (CP 1244) He opined that Ms. Nero’s past (\$48,750) and future earnings (\$309,000) totaled approximately \$360,000. (CP 1245)

B. Ms. Nero’s Future Medical Care Ranged from \$3.1 Million to \$7.4 Million.

Robert Moss created two scenarios based on the life care plans prepared by another expert to calculate Ms. Nero’s future medical care. (CP 1246) His opinion was based on the presumption that Ms. Nero, then 40 years old, had a life expectancy of another 41 years. (CP 1246) In scenario A (a lifetime of dialysis three times per week), Ms. Nero’s future medical care would cost approximately \$7.4 million. (CP 1246-47) In

scenario B (a retransplantation on an 8 ½ year cycle), her future medical care would cost approximately \$3.1 million. (CP 1247)

Mr. Moss opined that Ms. Nero’s future medical care and costs was the difference between scenario A and B, for a total of \$4.3 million. (CP 1247)

C. Respondent Dr. Cryst’s Proposed Jury Instruction Was Not Given.

Before Ms. Nero filed her lawsuit against Dr. Cryst, she signed a declaration in compliance with RCW 7.70A.020 (2), electing to opt out of Voluntary Arbitration based on her belief that her case should be heard by a jury “and because I believe the value of my claims far exceed the \$1 million cap on voluntary arbitration.” (CP 21-22)

On November 17, 2010, prior to trial, Ms. Nero submitted a four-sentence motion *in limine*, requesting the trial court to “exclude evidence relating to whether a recovery by Plaintiff would or would not be subject to federal income taxation or any other form of taxation” (citing *Hinzman v. Palmanteer*, 81 Wn.2d 327, 501 P.2d 1228 (1972); ER 401-403). (CP 335)

On November 23, 2010, Respondent Dr. Cryst submitted proposed jury instructions, including a proposed instruction that states as follows:

Any award to plaintiffs will not be subject to federal income tax and therefore you should not add or subtract for such taxes in fixing the amount of any award.

(CP 455) The proposed instruction contained federal statutory authority and case law authority in support of this instruction. (CP 455)

On March 18, 2012, the trial court heard oral argument on Ms. Nero's motion *in limine* that evidence of taxation of her potential jury award damages should be excluded. (RP at 105:9-25) In opposing this motion, Dr. Cryst's counsel first questioned the propriety of addressing the content of jury instructions in the context of a motion *in limine* (RP 105:20-25; RP 106:1-9), since a jury instruction regarding taxation of damages is not an evidentiary issue.

Second, Dr. Cryst's counsel stated on the record that she strongly opposed Ms. Nero's motion *in limine* because it is straightforward federal law that damage awards are not taxable, and a jury instruction that there is no federal income tax on any recovery by plaintiff is submitted in many jurisdictions. (RP at 105:14-17; RP 106:25 to 107:1-3)

The trial court did not understand that Ms. Nero was claiming wage loss (RP 107:6-11), and that Ms. Nero's pain and suffering damages are not taxable, as a matter of law. (RP 107:12-15) The trial court demonstrated its confusion by questioning Dr. Cryst's attorney about the appropriate tax rate that a jury should apply and to what extent they would

be speculating about a tax rate. (RP at 107:22-25 to 108:1-13) Counsel clarified that she simply wanted to tell the jury that Ms. Nero's damages are not subject to any tax. (RP at 108)

The trial court, confused, stated that "I'm not going to give somebody a jury instruction where I haven't given them any information. I mean, whether this is taxable or that's taxable or what rate it's taxable at, I mean, you know." (RP at 109:6-11) Dr. Cryst's attorney responded that if the court needed evidence to support the proposed jury instruction, then she would question Dr. Cryst's own rebuttal economist, Dr. Knowles, even though she believed it was purely an issue that could be covered by a jury instruction. (RP at 109)

The trial court granted Ms. Nero's motion *in limine*, but alerted counsel that "I think the law in Washington is that it isn't, and I certainly wouldn't tell a jury." (RP at 110:1-3) The trial court declined to submit Dr. Cryst's proposed jury instruction to the jury, based on its ruling granting Ms. Nero's motion *in limine*.

The Special Verdict Form contained six lines in Question 6, designating the jury's six separate monetary awards for: (1) past economic damages; (2) future economic damages; (3) Ms. Nero's noneconomic damages; and (4) her son's noneconomic damages. (CP 2231)

The jury's verdict was for the defense. (CP 2230-32) This appeal and cross appeal followed.

III. ARGUMENT

A. **The Federal Statute Expressly States that Damages Shall Not Be Taxed.**

Washington State has not implemented a state income tax, however, all citizens of this state are subject to federal taxation under the tortured and convoluted tax code administered by the Internal Revenue Service.

One section of the federal code is plain and unambiguous. 26 U.S.C. § 104 (a)(2) states, in relevant part, as follows:

§ 104. Compensation for injuries or sickness.

(a) In general. Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 [26 USCS § 213] (relating to medical, etc., expenses) for any prior taxable year, *gross income does not include—*

(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;

26 U.S.C. § 104 (a)(2) (emphasis added).

This statute also explains that gross income does not include: amounts received under workmen's compensation acts as compensation for personal injuries or sickness; amounts received through accident or

health insurance for personal injuries or sickness; amounts received as a pension, annuity or similar allowance for personal injuries or sickness resulting from active service in the armed forces; and amounts received by an individual as disability income attributable to injuries from terroristic or military action. 26 U.S.C. § 104 (a)(1), (3)-5).

B. The Cases Interpreting 26 U.S.C. § 104(a)(2) Favor Submitting a Jury Instruction Regarding Taxation of Damages.

The seminal case from which Dr. Cryst's proposed jury instruction arises is *Domeracki v. Humble Oil & Refining Co.*, 443 F.2d 1245 (3d Cir. 1971), *cert denied* 404 U.S. 883, 30 L. Ed. 2d 165, 92 S. Ct. 212 (1971), wherein a longshoreman filed suit for personal injuries sustained while loading a ship in port. The defendant submitted, and the district court refused, the following instruction:

I charge you, as a matter of law, that any award made to the plaintiff in this case, if any is made, is not income to the plaintiff within the meaning of the federal income tax law. Should you find that plaintiff is entitled to an award of damages, then you are to follow the instructions already given to you by this Court in measuring those damages, and in no event should you either add to or subtract from that award on account of federal income taxes.

Id. at 1248-49. The jury awarded the longshoreman \$270,982 in damages. The Third Circuit Court, in a case of first impression, ruled that the trial court erred by refusing to submit the above-referenced instruction to the jury.

The Third Circuit Court's analysis began with a plain reading of 26 U.S.C. § 104 (a), noting that "[i]t is true, as stated in the requested charge, that awards received by settlement or verdict in personal injury actions are not taxable under the federal income tax laws." *Id.* at 1249 (citing Section 104 of the Internal Revenue Code of 1954, 26 U.S.C.). The *Domeracki* Court acknowledged that "whether this is a fact of which a jury should be apprised, upon a defendant's request for a proper cautionary instruction, is an open question in this Circuit. Other courts, both state and federal, which have considered the question have answered it in different ways," although a majority of commentators "appear to favor an appropriately worded charge." *Id.* at 1249.

With the foregoing in mind, the Third Circuit began its analysis "with the elementary rule of damages in personal injuries actions: a plaintiff should be compensated (1) for monies of which he has been deprived and which presumably he would have received had he not been injured, including wages and earnings, past and future; and (2) for the expenses, inconveniences, and suffering which have been thrust upon him by virtue of his injuries." *Id.* at 1249-50. Accordingly, the purpose of

personal injury compensation is “neither to reward the plaintiff, nor to punish the defendant, but to replace plaintiff’s losses.” *Id.* at 1250.

The *Domeracki* Court stated that “[i]nsofar as wages are concerned, an injured plaintiff loses only his net or take-home pay, that is, his gross earnings, less taxes. He does not in fact ‘lose’ his gross earnings.” *Id.* at 1250. The Court noted that in most jurisdictions, “the courts hold that the gross earnings of the plaintiff, rather than net earnings after taxes, are admissible as evidence for the jury’s consideration in calculating this item of damages. Thus, the jury is presented not with evidence of wages which plaintiff has actually lost, but sums which, in fact, may be considerably higher depending upon his particular income tax bracket.” *Id.* at 1250.

One way to avoid this result is to submit a cautionary instruction to the jury. “The avowed purpose of such a request is to discourage a jury from enlarging an award to the extent it erroneously believes that the plaintiff will be called upon to pay income taxes.” *Id.* at 1250.

The *Domeracki* Court readily recognized the problems which could result from the introduction of income tax evidence, observing that “shifting tax rates, together with other variables, could give rise to great conjecture, at least as to *in futuro* earnings.” *Id.* The Court acknowledged that “the tax computation itself could completely overshadow the basic issues of liability and damages.” *Id.*

The *Domeracki* Court addressed the confusion and concern that the trial court expressed in the case at bar. The Court stated that although “some courts and writers have confused the evidentiary issue with the question of a cautionary instruction, we believe that the considerations relating to the former issue have no relevance to the second.” *Id.* at 1250-51. As such (and exactly like the issue in the present case on cross appeal before Division I),

- The instruction requested in this case would not require the introduction of any additional evidence.
- No reference to any IRS regulation or to any specific statute would be necessary.
- No tax expert would need to be summoned as a witness.
- No tax tables would be hauled into the courtroom.
- No additional computation would be required.
- In brief, such an instruction would not open the trial to matters irrelevant to traditional issues in personal injury litigation, and thus would in no way complicate the case or confuse the jury.

Id. at 1251.

With respect to policy considerations, the *Domeracki* Court ruled that “there are positive and persuasive reasons for giving the instruction.” *Id.* While this opinion was written in 1971, the policy discussion and rationale still ring true for 2012-13. The *Domeracki* Court acknowledged

that it was keenly aware of “the pervasive impact of taxation -- federal, state, and local -- in the lives of Americans.” *Id.* As both private citizens and as judges, members of the *Domeracki* Court took judicial notice “of the widespread attention given by the media to the tax consequences affecting winners of the Irish Sweepstakes, state-conducted lotteries, and contests conducted on television.”¹ *Id.* at 1251. In sum, the Court took “judicial notice of the ‘tax consciousness’ of the American public.” *Id.*

With respect to members of the general public, the *Domeracki* Court recognized (as did the court in *Dempsey v. Thompson*, 363 Mo. 339, 251 S.W.2d 42 (1952)), “that few members are aware of the special statutory exception for personal injury awards contained in the Internal Revenue Code.” *Id.* Accordingly, “there is always danger that today’s tax-conscious juries may assume (mistakenly of course) that the judgment will be taxable and therefore make their verdict big enough so that plaintiff would get what they think he deserves after the imaginary tax is

¹The *Domeracki* Court relied on a Second Court opinion wherein a dissenting judge opined that “[i]t is likely that many jurors, without such an instruction ... would believe that damage awards are taxable, and would weight this factor against the defendant. ... The public press has carried many reports of large sums won on television quiz programs or in lotteries and sweepstakes. These accounts almost always point out that a very large percentage of the winnings must be paid to the government as income tax. It would be natural enough for the layman to conclude that the plaintiff’s receipts from the judgment would be taxed.” *McWeeney v. New York, N.H. & H.R.R.*, 282 F.2d 34, 41, (2nd Cir. 1960) (*en banc*) (Lumbard, C.J., dissenting).

taken out of it.”” *Id.* at 1251 (quoting II Harper & James, *The Law of Torts* § 25.12, at 1327-28 (1956)).

In this cross appeal, Dr. Cryst invites the Court to consider that the “very purpose of a cautionary instruction is merely to dispel a possible misconception in the minds of the jury that the government will make a valid claim to a portion of the award. Its effect is simply to dissuade juries from improperly increasing the award because of this mistaken belief.” *Id.* at 1251.

In a similar case, the Ninth Circuit, adopted the holdings and rationale stated in *Domeracki*. The Ninth Circuit held as follows:

We find ourselves in complete agreement with these sentiments. We cannot believe that, in the absence of such an instruction, many jurors would not assume that the award would be taxable and thus be inclined to increase their damage award accordingly. The benefits of informing the jury of the true tax consequences are so clear, and the burden in terms of time and the possibility of confusion so minimal, that we believe the balance is overwhelmingly in favor of giving such an instruction. To put the matter simply, giving the instruction can do no harm, and it can certainly help by preventing the jury from inflating the award and thus overcompensating the plaintiff on the basis

of an erroneous assumption that the judgment will be taxable.

Burlington N., Inc. v. Boxberger, 529 F.2d 284, 297 (9th Cir. 1975).

In sum, “given the absence of complications that an instruction would engender, the tax consciousness of the American public, and the general lack of knowledge about the statutory exclusion,” the *Domeracki* Court held that “in personal injuries actions the trial courts in this Circuit must, in the future, upon request by counsel, instruct the jury that any award will not be subject to federal income taxes and that the jury should not, therefore, add or subtract taxes in fixing the amount of any award.” *Domeracki*, 443 F.2d at 121. This is precisely the instruction that Dr. Cryst seeks if this case is reversed and remanded to the trial court.

C. The United States Supreme Court Favors a Jury Instruction Regarding Taxation of Damages.

In a 1980 wrongful death claim brought under the Federal Employers’ Liability Act, the United States Supreme Court was asked to consider: (1) whether it was error to exclude evidence of the income taxes payable on the decedent’s past and estimated future earnings; and (2) whether it was error for the trial judge to refuse to instruct the jury that the award of damages would not be subject to income taxation.² *Norfolk &*

² The Supreme Court decided to answer these two questions because “most trial judges refuse to allow the jury to receive evidence or instruction concerning the impact of federal income taxes on the amount of damages to be awarded.” *Id.* at 491. The Court acknowledged that the

W. Ry. Co. v. Liepelt, 444 U.S. 490, 490-491, 100 S. Ct. 755, 62 L. Ed. 2d 689 (1980).

This case arose from fatal injuries that a fireman suffered in a collision in 1973. The plaintiff, as administratrix of the fireman's estate, brought suit under the FELA to recover the damages that his survivors suffered as a result of his death. *Id.* at 491. In 1976, after a full trial in Chicago, the jury awarded plaintiff \$775,000. *Id.* On appeal, the Appellate Court of Illinois held that it was "not error to refuse to instruct a jury as to the nontaxability of an award" and also that it was "not error to exclude evidence of the effect of income taxes on future earnings of the decedent." *Id.* at 491 (citing *Liepelt v. Norfolk & W.R. Co.*, 62 Ill. App. 3d 653, 669, 378 N.E.2d 1232, 1245 (1978)). The United States Supreme Court reversed this decision.

The *Liepelt* Court stated that "whether it was error to refuse that instruction, as well as the question whether evidence concerning the federal taxes on the decedent's earnings was properly excluded, is a matter governed by federal law." *Liepelt*, 444 U.S. at 492-93. Accordingly, in a wrongful death case under the FELA, the measure of recovery is "the damages . . . [that] flow from the deprivation of the pecuniary benefits which the beneficiaries might have reasonably received. . . ." *Id.* at 493

prevailing practice of not submitting this jury instruction "developed at a time when federal taxes were relatively insignificant" and also because some courts are now following a different practice. *Id.* at 491.

(quoting *Michigan Central R. Co. v. Vreeland*, 227 U.S. 59, 70, 33 S. Ct. 192, 57 L. Ed. 417 (1913)).

The United States Supreme Court acknowledged that the “amount of money that a wage earner is able to contribute to the support of his family is unquestionably affected by the amount of the tax he must pay to the Federal Government.” *Liepelt*, 444 U.S. at 493. Consistent with the *Domeracki* decision, the *Liepelt* Court noted that it is his “after-tax income, rather than his gross income before taxes, that provides the only realistic measure of his ability to support his family. It follows inexorably that the wage earner’s income tax is a relevant factor in calculating the monetary loss suffered by his dependents when he dies.” *Id.* at 493-94.

Beginning with the federal statute, the Supreme Court noted that Section 104 (a)(2) of the Internal Revenue Code of 1954, 26 U.S.C. § 104 (a)(2), “provides that the amount of any damages received on account of personal injuries is not taxable income.” *Id.* at 494. In *Liepelt*, the Court acknowledged that while the law is perfectly clear, “it is entirely possible that the members of the jury may assume that a plaintiff’s recovery in a case of this kind will be subject to federal taxation, and that the award should be increased substantially in order to be sure that the injured party is fully compensated.” *Id.* at 496.

Following the rationale of the Missouri Supreme Court, the *Liepelt* Court opined that “it is reasonable to assume the average juror would

believe [that its verdict will] be subject to such taxes.” *Id.* at 496-97 (quoting *Dempsey v. Thompson*, 363 Mo. 339, 346, 251 S.W.2d 42, 45 (1952) (later superceded by statute in *Tennis v. General Motors Corp.*, 625 S.W.2d 218 (1981)).

The *Liepelt* Court also acknowledged the that “[There] is always danger that today’s tax-conscious juries may assume (mistakenly of course) that the judgment will be taxable and therefore make their verdict big enough so that plaintiff would get what they think he deserves after the imaginary tax is taken out of it.” *Id.* at 497 (quoting II Harper & James, *The Law of Torts* § 25.12, at 1327-28 (1956) (footnote omitted) from *Domeracki v. Humble Oil & Refining*, 443 F.2d 1245, 1251 (1971), *cert. denied*, 404 U.S. 883)).

In *Liepelt*, an expert witness computed the amount of pecuniary loss at \$302,000, plus the value of the care and training that deceased fireman would have provided to his young children. However, the jury awarded damages of \$775,000. “It is surely not fanciful to suppose that the jury erroneously believed that a large portion of the award would be payable to the Federal Government in taxes, and that therefore it improperly inflated the recovery.” *Id.* at 497. The United States Supreme Court held that, whether or not this speculation is accurate, it agrees with the Ninth Circuit: “[to] put the matter simply, giving the instruction can do no harm, and it can certainly help by preventing the jury from inflating

the award and thus overcompensating the plaintiff on the basis of an erroneous assumption that the judgment will be taxable.” *Id.* at 497-98 (quoting *Burlington N., Inc. v. Boxberger*, 529 F.2d 284, 297 (1975)).

The *Liepelt* Court held that it was error to refuse the requested instruction in that case. “That instruction was brief and could be easily understood. It would not complicate the trial by making additional qualifying or supplemental instructions necessary. It would not be prejudicial to either party, but would merely eliminate an area of doubt or speculation that might have an improper impact on the computation of the amount of damages.” *Id.* at 498.

Likewise, Ms. Nero, who sought millions of dollars in past and future wages and medical expenses, would not be prejudiced by the simple instruction proposed by Dr. Cryst. That neutral instruction, taken from *Domeracki* is the federal law:

Any award to plaintiffs will not be subject to federal income tax and therefore you should not add or subtract for such taxes in fixing the amount of any award.

(CP 455)

IV. CONCLUSION

Respondents Dr. Cryst and Virginia Mason Medical Center respectfully request that the Court reverse the trial court's ruling wherein it refused to submit an instruction to the jury that any award will not be subject to federal income tax. The merits of this issue on cross appeal may only be reached if this Court is inclined to reverse and remand the Ms. Nero's case on appeal.

Dated this 5 day of June, 2012.

Respectfully submitted,

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CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that on the 5th day of June, 2012, I caused to be served a true and correct copy of the foregoing via e-mail and U.S. Mail, to the following:

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