

67663-6

67663-6

No. 67663-6-I

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

WISTERIA CORPORATION, et. al.,

Appellants,

v.

BOND SAFEGUARD INSURANCE COMPANY, a foreign corporation,

Respondents.

FILED
COURT OF APPEALS DIV I
STATE OF WASHINGTON
2012 APR -9 PM 4:10

APPELLANTS' OPENING BRIEF

Scott E. Stafne, WSBA #6964
Andrew Krawczyk, WSBA #42982
Stafne Law Firm
239 North Olympic Ave.
Arlington, WA 98223
Phone: (360) 403-8700
Fax: (360) 386-4005

TABLE OF CONTENTS

I. INTRODUCTION.....1

II. ASSIGNMENTS OF ERROR.....1

III. STATEMENT OF THE CASE.....1

 A. Facts Raised at Summary Judgment.....2

 1. *Wombat and Turtle Pole Timber Deals*.....2

 2. *Wisteria Posted Four Bonds for Timber Deals*.....3

 3. *The Dispute That Arose Between Wisteria and DNR*.....5

 4. *Despite Wisteria’s Objections, Bond Safeguard Capitulates to DNR*.....7

 B. New Facts Raised on Motion for Reconsideration.....8

 C. Procedural History.....9

IV. ARGUMENT.....10

 A. Standard of Review.....10

 1. *Grant of Summary Judgment*.....10

 2. *Denial of Motion for Reconsideration*.....12

 B. Scope of Duties for Bond Surety.....12

 1. *Implied Duty of Good Faith*.....16

 2. *Standard of Reasonableness*.....17

 3. *Factors to Be Considered In Determining Whether a Surety Met the Standard*.....18

 4. *Wisteria Raises Genuine Issue of Fact of Failure to Conduct Reasonable Investigation*.....20

V. CONCLUSION.....23

TABLE OF AUTHORITIES

Washington Cases

| | |
|---|--------|
| <i>Alexander v. County of Walla Walla</i> , 84, Wn. App. 687, 929 P.2d 1182 (1997)..... | 11 |
| <i>Badgett v. Security State Bank</i> , 116 Wn.2d 563, 807 P.2d 356 (1991)..... | 16 |
| <i>Brinnon Grp. v. Jefferson County</i> , 159 Wn. App. 446, 245 P.3d 789 (2011)..... | 12 |
| <i>Coventry Assocs. v. Amer. States Ins. Co.</i> , 136 Wn.2d 269, 961 P.2d 933 (1998)..... | 16, 17 |
| <i>Davis v. West One Automotive Group</i> , 140 Wn. App. 449, 166 P.3d 807 (2007)..... | 11 |
| <i>Farrington Corp. v. Commonwealth Land Title Ins. Co.</i> , 86 Wn. App. 399, 936 P.2d 1157 (1997)..... | 18 |
| <i>Frank Coluccio Constr. v. Kind County</i> , 136 Wn. App. 751, 150 P.3d 1147 (2007)..... | 16 |
| <i>Hisle v. Todd Pac. Shipyards Corp.</i> , 151 Wn.2d 853, 93 P.3d 108 (2004)..... | 11 |
| <i>Industrial Indemnity v. Kallevig</i> , 114 Wn.2d 907, 762 P.2d 520 (1990)..... | 16 |
| <i>Libergesell v. Evans</i> , 93 Wn.2d 881, 613 P.2d 1170 (1980)..... | 16 |
| <i>Lonsdale v. Chesterfield</i> , 99 Wn.2d 353, 662 P.2d 385 (1983)..... | 16 |
| <i>Metropolitan Park District v. Griffin</i> , 106 Wn.2d 425, 732 P.2d 1093 (1986)..... | 16 |
| <i>Moore v. Pacific Northwest Bell</i> , 34 Wn. App. 448, 662 P.2d 398 (1983)..... | 11 |

| | |
|--|------------|
| <i>Owen v. Burlington Northern and Santa Fe R.R. Co.</i> , 153 Wn.2d 780, 108 P.3d 1220 (2005)..... | 11 |
| <i>Tank v. State Farm Fire & Casualty Co.</i> , 105 Wn.2d 381, 715 P.2d 1133 (1986)..... | 13 |
| <i>Tyler v. Grange Ins. Ass'n</i> , 3 Wn. App. 167, 173, 473 P.2d 193 (1970)..... | 17 |
| Federal Cases | |
| <i>Fireman's Fund Ins. Cos. v. Alaskan Pride Partnership</i> , 106 F.3d 1465 (9th Cir. 1997)..... | 17 |
| <i>National Sur. Corp. v. Peoples Mill. Co.</i> , 57 F. Supp. 281 (D.C. KY 1994)..... | 17 |
| <i>U.S. Fid. & Guar. Co. v. Feibus</i> , 15 F. Supp. 2d 579, (M.D. Pa 1998) <i>aff'd</i> , 185 F.3d 864 (3 rd Cir. 1999)..... | 16 |
| Washington Statutes and Regulations | |
| RCW 48.02.060..... | 14 |
| RCW 48.30.010..... | 13-14, 17 |
| WAC 284-30-30..... | 14-15 |
| WAC 284-30-320..... | 17, 20 |
| WAC 284-30-330..... | 14, 15, 20 |
| WAC 284-30-370..... | 17 |
| WAC 284-30-380..... | 14-15 |

WAC 284-30-390..... 14-15

WAC 284-30-395..... 14-15

Authority From Other Jurisdictions

Atlantic Contracting & Material Co., Inc. v. Ulico Cas. Co.,
380 Md. 285, 844 A.2d 460 (2004) 19

City of Portland v. Ward & Associates, 89 Or. App. 452, 750
P.2d 171 (1988) 17, 19, 20

Fidelity & Dep. Co. of Md. v. Davis, 22 Kan. 790,
284 P. 430 (Kan. 1930)..... 16, 17

Hartford v. Tanner, 22 Kan. App.2d 64, 910 P.2d 872
(1996)..... 17, 20

Hawaiian Ins. & Guar. Co., Ltd. v. Higashi, 67 Haw. 12, 675
P.2d 767 (1984)..... 17

Secondary Sources

Bengt Holmstrom, MORAL HAZARD AND OBSERVABILITY,
10 Bell J. Econ. 74 (1979)..... 13

J.W. Hinchey, SURETY’S PERFORMANCE OVER PROTEST OF
PRINCIPAL: CONSIDERATION AND RISKS, 22 Tort & Ins. L.J.
133 (Fall 1986)..... *passim*

Steven Shavell, RISK SHARING AND INCENTIVES IN THE
PRINCIPAL AND AGENT RELATIONSHIP,
10 Bell J. Econ. 55 (1979)..... 13

I. INTRODUCTION

This is an appeal from order granting summary judgment and denial of reconsideration thereof, and primarily concerns an open question of Washington Law. While on first blush this appears to be a contract dispute, it concerns the practice of government agencies using indemnity and insurance bonds to thwart due process and dispute resolution.

In regards to the question of law, Appellants Wisteria Corporation, Chris and Stacie Hatch (collectively “Wisteria”) respectfully request this court determine standards of care applied to a surety, Bond Safeguard Insurance Company (“Bond Safeguard”), when it pays claims over the objections of the principal; and then under such standard(s), whether this case presents a genuine issue of fact of compliance with those standards.

II. ASSIGNMENTS OF ERROR

1. Whether the Trial Court erred in finding Bond Safeguard had no duty to conduct a reasonable investigation of the claim prior to settling with Washington State Department of Natural Resources (“DNR”)?
2. Whether the Trial Court erred in finding no genuine issue of material fact that Bond Safeguard breached its duties to Wisteria when it settled with DNR?

III. STATEMENT OF THE CASE

A. Facts Raised at Summary Judgment

1. Wombat and Turtle Pole Timber Deals

Wisteria is a logging company who entered into two contracts for timber sales with the Washington State Department of Natural Resources (“DNR”). *See* CP 152-154. On March 14, 2005, Wisteria won the bid for the Wombat SWT timber sale from DNR giving it the right to log approximately 177 acres in Skagit County. CP 152. The contract gave Wisteria until September 30, 2006 to complete work, but Wisteria could request an extension for delays beyond the Company’s control, and purchase at least two extensions if it was making reasonable progress on the work. CP 152.

On July 6, 2005, Wisteria was the successful bidder on the Turtle Pole contract with DNR. CP 152. This involved timber harvest on 141 acres in Kittitas County near Easton, WA. CP 106; CP 110-130 (Turtle Pole Contract); CP 152. Similar to the Wombat contract, the initial term was under September 30, 2006, and Wisteria could obtain extensions for delays beyond the Company’s control or for purchase. CP 152.

Terms of contracts. Both contracts had extensive dispute resolution procedures, which both parties agreed “***must be followed before a lawsuit***

can be initiated. “ CP 152-53 (emphasis supplied).¹ Both contracts required Wisteria to provide two bonds: a payment security and a performance security. The payment security protected DNR if Wisteria failed to pay for the timber logged. CP 153. The performance security bond protected the State if Wisteria failed to complete the contract. CP 153-54, CP 248:7-8.

2. *Wisteria Posted Four Bonds for Timber Deals*

Bond Safeguard was contacted by Wisteria to obtain bonds. CP 248:9-10. Wisteria then posted four Bonds:

- Performance Bond No. 5020306 for \$12,000, dated Dec ember 13, 2005;
- Blanket Payment Security Bond No. 5021036 for an additional \$10,000, dated February 3, 2006;
- Performance Bond No. 5020305 for \$17,000, dated December 13, 2005; and,

¹ As more fully explained below, Wisteria’ response to summary judgment specifically contended that the agency failed to follow these requirements, and notified Bond Safeguard of this. See CP 153:16-17, 157-159 (e.g., “DNR refused any demand at dispute resolution. On November 20, 2006, R. Bruce Mackey, DNR Lands Steward tersely refused to meet with Wisteria. [***] On April 16, 2007, Wisteria gave Bond Safeguard written notice of its defenses to the State’s allegations.”)

- Blanket Payment Security Bond No. 5022533 for an additional \$10,000, dated June 26, 2006.

See CP 154; *see also*, CP 249-250, CP 252:7-9; *see generally*, CP 167-246. Wisteria and Bond Safeguard signed a General Agreement of Indemnity that governed the terms of all four bonds. CP 154-55; *see* CP 167-246 (Dec. of Friedrich and exhibit A attached thereto). Paragraph 2 states:

In the event of payment by the Company, the Indemnitors agree to accept the voucher or other evidence of such payment as prima facie evidence of the propriety thereof, and of the Indemnitor's liability to the Company.

Id. Paragraph 5 granted the bonding company a right to settle as follows:

The Company shall have the exclusive right to determine for itself and Indemnitors whether any claim or suit shall settled or defended and its decision shall be binding and conclusive upon Indemnitors.

Id. Paragraph 7 granted the right to settle without notice to Wisteria, as follows:

[I]t shall not be necessary for the Company to give Indemnitors, or any one or more of the parties so designated, notice of the execution any such bonds, nor of any fact or information coming to the notice or knowledge of the Company affecting its rights or liabilities, or the rights or liabilities of the Indemnitors under any such bond executed by it, notice of all such being expressly waived.

Id.

3. *The Dispute That Arose Between Wisteria and DNR*

The work for the Turtle Pole harvest began in June of 2006, with logging in August 2006. CP 131-133; CP 155. To prepare for the harvest in Unit #1, Wisteria marked the trees with orange paint bands and butt marks. CP 134-135; CP 155. After cutting, Wisteria would identify the location of the fallen tree with a pole tag. CP 155. Prior to logging, DNR visited the site “to approve the pole marking and verify the attached marking table provided to DNR by the purchaser and they marked approx. 130 poles.” CP 131; CP 155. The 130 pole estimate by DNR was grossly inaccurate, Wisteria had, in fact, marked more than 240 trees. CP 155. In August 2006, DNR gave Wisteria 130 pole tags to attach to harvested tree stumps, assuming that 130 trees were marked. CP 155-56. Wisteria believed it had approval to cut all marked trees, starting with the first 130. CP 156.

On September of 2006, Wisteria and DNR discovered the mistake that gave rise to this lawsuit, how many trees were approved to be cut on Unit #1 of Turtle Pole. CP 156, 157. First, DNR issued a stop work order for Wisteria’s failure to pay \$12,234 for the 130 pole tags. CP 136-37, CP

156. Because the Turtle Pole contract was due to expire on September 31, 2006, Wisteria requested a three-month extension to finish the work; which DNR replied to on September 21, 2006 stating certain terms. CP 156. Six days later, on September 27, 2006, DNR sent Wisteria a second letter which complained that Wisteria removed 240 trees not 130, and suspended operations. CP 138-39, 156. While, Wisteria complied with the letter and paid for all untagged trees, DNR subsequently shut down all operations, unilaterally terminating it. 156-157. Offers and Counteroffers were made. CP 141-144, CP 157-158. On November 30, 2006, Wisteria requested a written decision to trigger the dispute resolution clause in the contract. CP 145-46; CP 158. DNR refused any demand at dispute resolution, making no mention of the contract requirements for a formal hearing before him. CP 147, 158. From this point on, the Agency sought only to collect liquidated damages on the alleged breach. *See Id.*

The dispute then spilled over to the Wombat Contract, and DNR was unwilling to work with Wisteria on either contract. CP 159. On March 15, 2007, DNR unilaterally declared the contract expired even though Wisteria requested an extension. CP 167-246 (Dec. of Friedrich and exhibit E attached thereto). Wisteria tendered full payment for an extension, but the agency claimed it was too late. CP 158; CP 167-246 (Dec. of Friedrich and exhibit F attached thereto).

4. *Despite Wisteria's Objections, Bond Safeguard Capitulates to DNR*

In December of 2006, the State made its first demand for payment from Wisteria's surety. CP 159. Wisteria opposed any payment on the Contested Claims. CP 159. On April 16, 2007, Wisteria gave Bond Safeguard written notice of its defenses to the State's allegations:

Wisteria, your bonding company's principal, entered into a timber sale contract with the State of Washington which contained two separate cutting areas. Wisteria commenced its operations and a dispute arose as to whether Wisteria should have harvested poles from the second cutting area. DNR contended that Wisteria had to obtain separate approval before such cutting. Wisteria disputes this as both cutting areas are contained within the same contract and should be treated equally. As a result, DNR is alleging that we have cut more timber than allowed by contract. Wisteria has not cut more poles than the contract provided for.

The State now claims to be owed \$19,234.00 which they call the "value of unauthorized removals." Adding to that is the balance of the claim for liquidated damages. This claim is disputed since there was no breach of contract by Wisteria and, in fact, Wisteria was ready, willing and able to complete the job, however, DNR refused an extension, which are routinely granted.

CP 148-149 (Hayes Letter), 159.

The State applied counter-pressure on Bond Safeguard, filing complaints with the Washington Office of Insurance Commissioner and Illinois Department of Financial and Professional Regulation. CP 160.

Given the choice of defending Wisteria or avoiding the complaints, Bond Safeguard chose to protect itself. CP 160; *see also*, CP 248:18-19 (“Bond Safeguard was forced to pay the Department in order to protect itself against further liability”); CP 250:26-251:12, 253:7-8 (extent of Bond Safeguard’s participation was emails encouraging parties to communicate and settle, arrangement of meeting to negotiate a compromise, and optimism); CP 251:11-14 (admission that Bond Safeguard neglected or didn’t look further into the matter “for reasons unknown to Bond Safeguard” as to why settlement was not reached); CP 251:15-252:2, 253:12-14 (reason Bond Safeguard paid was because “Department [DNR] was so infuriated” and that DNR initiated complaints with Insurance commissions).

On September 20, 2007, Bond Safeguard paid \$27,000 on the Turtle Pole contract, and \$17,007.64 on the Wombat contract. This was contrary to Wisteria’s written direction and undermined settlement talks with DNR. CP 160

B. New Facts Raised on Motion for Reconsideration

On Motion for Reconsideration, Wisteria’s counsel predominately elaborated on the legal arguments made on summary judgment using facts already supplied in the motion for summary judgment. *See*, CP 167-246

(Dec. of Friedrich and exhibits L and Z attached thereto). *see generally*, CP 54-55; *but see*, CP 55-56; CP 80-83 (Dec. of Phillip Buri and exhibits A and B attached thereto). CP 82 (the “Diaz request”) was introduced to support the contention that the only one communication between the claims department and DNR. CP 83 (the Maas Email”) demonstrated Bond Safeguard relied on others to determine what claims and counterclaims were worth, and the plaintiff’s lack of independent knowledge about the case.

C. Procedural History

Bond Safeguard filed the complaint in Whatcom County Superior Court for indemnification and money damages on December 22, 2010. CP 261-265. They then filed for Summary Judgment on May 19, 2011 (prior to significant discovery). CP 165-166, 247-259; *see*, Lynn Webber Transcript, at 16:1 (July 29, 2011). Responses and replies were then filed by the parties. *See* CP 150-166 (Wisteria Response); CP 101-105 (Reply). Summary Judgment was granted on July 29, 2011; but, the Hon. Judge Charles Snyder invited reconsideration. *See* CP 98-101 (Order); *see also*, Lynn Webber Transcript, at 21:6-25 (July 29, 2011). Counsel for Wisteria then moved for reconsideration (CP 48-79, 84-85), opposed by Bond Safeguard (CP 34-47), and opposition replied to (CP 14-19). After

argument on August 26, 2011, the motion was denied. *See* CP 12-13; *see also*, Rhonda Jensen Transcript, at 13:14-18.² Wisteria filed Notice of Appeal on September 9, 2011, to review Order granting summary judgment, and order denying Wisteria's motion for reconsideration. CP 4-11; *see also*, CP 12-13, 98-101.

IV. ARGUMENT

A. Standard of Review

Standard of Review differs, with respect to the facts, between a grant of summary judgment and denial of a motion for reconsideration. Because this matter involves the standard of law in Washington (and Wisteria's counsel at the time's motion for reconsideration involved elaboration of existing arguments)(*Compare generally*, 48-56 with 150-166) this Court should predominately review this matter under its *de novo* standard of review.

1. Grant of Summary Judgment

²Therein:

[THE COURT:] Now, the court of appeals and the state supreme court might change that. They might write a new standard. I don't think that is the trial court's job. I think that is the job of the appellate courts. So I'm going to deny the motion.

Rhonda Jensen Transcript, at 13:14-18.

A trial court properly grants summary judgment only when no genuine issues of material fact exist, thereby entitling the moving party to a judgment as a matter of law. CR 56(c). A Court on review of an order to grant or deny summary judgment, enters into the same inquiry as the trial court, i.e., the court must consider the facts submitted and draw all reasonable inferences from the facts in the light most favorable to the nonmoving party. *Hisle v. Todd Pac. Shipyards Corp.*, 151 Wn.2d 853, 860-61, 93 P.3d 108 (2004); *Davis v. West One Automotive Group*, 140 Wn. App. 449, 456, 166 P.3d 807 (2007). Questions of fact may be determined on summary judgment as a matter of law only where reasonable minds could reach but one conclusion. *Owen v. Burlington Northern and Santa Fe R.R. Co.*, 153 Wn.2d 780, 108 P.3d 1220 (2005); *Alexander v. County of Walla Walla*, 84, Wn. App. 687, 692, 929 P.2d 1182 (1997); *see also, Moore v. Pacific Northwest Bell*, 34 Wn. App. 448, 456, 662 P.2d 398 (1983) (where there is a genuine issue as to any material fact, however, a trial is not useless, but is absolutely necessary).

Here Summary Judgment was granted. CP 98-101. Under its *de novo* review, the court should examine CP 261-265 (Complaint); CP 167-246 (Dec. of Paul Friedrich); CP 101-105 (Plaintiff's reply); CP 150-166 (Defendants Response in Opposition to Summary Judgment); CP 106-149

(Dec. of Phillip Buri in Opposition to Plaintiffs Motion for Summary Judgment); CP 4-11 (Order); Lynn Webber Transcript (July 29, 2011).

2. Denial of Motion for Reconsideration

Here the motion for reconsideration was denied. *See* CP 12-13. Where the Motion is based on new matters, such as additional facts or new arguments or legal theories that were not presented during the course of the proceedings leading to the issuance of the order being challenged, the abuse of discretion standard applies. *Brinnon Grp. v. Jefferson County*, 159 Wn. App. 446, 485, 245 P.3d 789 (2011). As mentioned above, only two additional facts were presented. *See* CP 82-84.

B. Scope of Duties for Bond Surety

As noted in by one commentator, the “specific terms of a general indemnity agreement will vary from surety to surety, but the essentially the objective of such agreements is to facilitate the handling of settlements by sureties and obviate the unnecessary and costly litigation.” J.W. Hinchey, SURETY’S PERFORMANCE OVER PROTEST OF PRINCIPAL: CONSIDERATION AND RISKS, 22 Tort & Ins. L.J. 133, 142 (Fall 1986). In facilitating settlements and obviating litigation, the surety placed in the role of judicial substitute (as they describe, and as such should be favored in manners which should encourage sometimes conflicting neutrality and

expediency. Principal-agent theory recognizes conflicts of interest between different economic actors, formalizing these conflicts through the inclusion of observability problems and asymmetries of information. *See, e.g.,* Bengt Holmstrom, MORAL HAZARD AND OBSERVABILITY, 10 Bell J. Econ. 74 (1979); Steven Shavell, RISK SHARING AND INCENTIVES IN THE PRINCIPAL AND AGENT RELATIONSHIP, 10 Bell J. Econ. 55 (1979); *c.f., Tank v. State Farm Fire & Casualty Co.*, 105 Wn.2d 381, 387, 715 P.2d 1133 (1986) (where potential conflicts of interest between insurer and insured inherent mandate an even higher standard, and this enhanced obligation is fulfilled by meeting specific criteria). Washington legislature has weighed in on this issue in enacting RCW 48.30.010, which states:

(1) No person engaged in the business of insurance shall engage in unfair methods of competition or in unfair or deceptive acts or practices in the conduct of such business as such methods, acts, or practices are defined pursuant to subsection (2) of this section.

(2) In addition to such unfair methods and unfair or deceptive acts or practices as are expressly defined and prohibited by this code, the commissioner may from time to time by regulation promulgated pursuant to chapter 34.05 RCW, define other methods of competition and other acts and practices in the conduct of such business reasonably found by the commissioner to be unfair or deceptive after a review of all comments received during the notice and comment rule-making period.

RCW 48.30.010. Pursuant to RCW 48.30.010(2) and RCW 48.02.060, the Insurance Commissioner promulgated regulations governing insurance trade practices. See WAC 284-30-300 *et seq.* WAC 284-30-330 defines 19 types of conduct which constitute "unfair or deceptive acts or practices in the business of insurance, specifically applicable to the settlement of claims." See WAC 284-30-330; WAC 284-30-380; WAC 284-30-390; WAC 284-30-395. The prohibited practices include:

- Misrepresenting facts or policy provisions to insureds or claimants;
- Failing to acknowledge and act reasonably promptly upon communications;
- Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims;
- Failing to effectuate prompt, fair and equitable settlements of claims in which an insurer's liability has become reasonably clear;
- Failing, upon payment of a claim, to inform insureds or beneficiaries of the coverage under which payment was made;

- Failing to provide a reasonable explanation for a coverage denial; and
- Refusing to pay a claim without first conducting a reasonable investigation.

Id. These common strategies to prohibit such practices include emphasis on information gathering; discouraging length separation from the process. Thus, a feint of ignorance does not bolster confidence in resolution and allows for abuse of process.

Here, the facts in favor of Wisteria show that the settlement was lodged over the protest of the Principal/Indemnitor; and the surety knew of such. CP 108, 151 (Hayes letter). The issue, as argued at both Summary Judgment and on Reconsideration, is what is the scope of the underlying standard in Washington State? CP 49-50. Different jurisdictions have adopted different baseline standards where settlement or performance is done over the principal's protest: "(a) that the surety did not perform or settle in good faith; or (b) That the surety did not act in a reasonable and prudent manner." It is an open question which applies in Washington. However, once the underlying standard is established, the next question is what factors evidence the meeting or failure of that standard; and whether

defendants in this case raised a genuine issue of fact concerning those factors.

1. Implied Duty of Good Faith

It cannot be said that the surety does not have some underlying standard of care to the principal. Washington, at least, implies a duty of good faith and fair dealing into all contracts. See *Badgett v. Security State Bank*, 116 Wn.2d 563, 569-570, 807 P.2d 356 (1991); *Industrial Indemnity v. Kallevig*, 114 Wn.2d 907, 762 P.2d 520 (1990); *Metropolitan Park District v. Griffin*, 106 Wn.2d 425, 437, 732 P.2d 1093 (1986); *Lonsdale v. Chesterfield*, 99 Wn.2d 353, 662 P.2d 385 (1983); *Libergesell v. Evans*, 93 Wn.2d 881, 891-92, 613 P.2d 1170 (1980); *Frank Coluccio Constr. v. Kind County*, 136 Wn. App. 751, 766, 150 P.3d 1147 (2007); see also, J.W. Hinchey, 22 Tort & Ins. L.J. at 149; CP 101 (citing *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d 579, 585 (M.D. Pa 1998) *aff'd*, 185 F.3d 864 (3rd Cir. 1999) (exception to enforcement of principal's liability include bad faith or fraudulent payment). In Washington, an insurer can be found to have acted in "bad faith" even when correctly denying a claim, if the denial was made without a reasonable investigation first. See *Coventry Assocs. v. Amer. States Ins. Co.*, 136 Wn.2d 269, 961 P.2d 933 (1998).

2. *Standard of Reasonableness.*

Courts in sister jurisdictions like Oregon, have required a surety's settlement to not only be in good faith, but also reasonable. *See e.g., City of Portland v. Ward & Associates*, 89 Or. App. 452, 458, 750 P.2d 171, 175 (1988); *accord, Hawaiian Ins. & Guar. Co., Ltd. v. Higashi*, 67 Haw. 12, 13, 675 P.2d 767, 769 (1984) ("even if an indemnitee has a legal right to settle a claim, the settlement must be reasonable and made in good faith"); *National Sur. Corp. v. Peoples Mill. Co.*, 57 F. Supp. 281, 283 (D.C. KY 1994) ("an adjustment or settlement be a reasonable one and made in good faith). In Kansas, the court has held:

The facts of this case present compelling reasons why a surety should be held to a standard of reasonableness. Thus we agree with those cases that hold that the implied covenant of good faith requires a surety seeking indemnification to show that its conduct was reasonable.

Hartford v. Tanner, 22 Kan. App.2d 64, 76, 910 P.2d 872, 880-881 (1996)(citations omitted); *see also, Fidelity & Dep. Co. of Md. v. Davis*, 22 Kan. 790, 800-801, 284 P. 430 (Kan. 1930); J.W. Hinchey, 22 Tort & Ins. L.J. at 149.

Washington's Unfair Claims Settlement Practices Regulations apply to "any contract of [***] suretyship." WAC 284-30-320(7); RCW 48.30.010 Further, Under WAC 284-30-370:

Every insurer must complete its investigation of a claim within thirty days after notification of claim, unless the investigation cannot reasonably be completed within that time. All persons involved in the investigation of a claim must provide reasonable assistance to the insurer in order to facilitate compliance with this provision.

3. *Factors to Be Considered In Determining Whether a Surety Met the Standard*

Under either standard, several factors evidence whether the surety acting in good faith or reasonably when settling over the protest of the Principal/Indemnitor. *C.f.*, *Coventry*, 136 Wn.2d 269³; *Tyler v. Grange Ins. Ass'n*, 3 Wn. App. 167, 173, 177, 473 P.2d 193 (1970); *Fireman's Fund Ins. Cos. v. Alaskan Pride Partnership*, 106 F.3d 1465, 1470 (9th Cir. 1997) (insurer's reliance on First Circuit Court of Appeals' case

³ Therein:

In 1997, the Court of Appeals decided *Farrington Corp. v. Commonwealth Land Title Ins. Co.*, 86 Wn. App. 399, 936 P.2d 1157 (1997). The court held that although material issues of fact existed as to whether Commonwealth conducted a reasonable investigation, Farrington could not bring a bad faith claim because the policy provided no coverage. *Farrington*, 86 Wn. App. at 405. *Farrington* is inconsistent with our holding in this case and, to the extent it stands for a proposition counter to our holding, it is overruled.

Coventry, 136 Wn.2d at 280, FN 3.

holding that failure to conduct a reasonable investigation could not alone support a finding of bad faith is "misplaced" because "[t]hat is not true of Washington law"); *City of Portland*, 89 Or. App. at 458, 750 P.2d at 175.

In *Atlantic Contracting & Material*, Maryland's highest court found that:

the factors to be considered in determining whether a surety made *a reasonable, good faith settlement* under the terms of the bond and the indemnity agreement are the following: *(1) the obligations of the surety as provided by the terms and coverage of the bond; (2) whether the principal has made more than generalized demands that the surety deny the claim; (3) the cooperation, or lack thereof, by the principal, in dealing with the surety; and (4) thoroughness of the investigation performed by the Surety.*

Atlantic Contracting & Material Co., Inc. v. Ulico Cas. Co., 380 Md. 285, 309, 844 A.2d 460, 474 (2004) (citing to *J.W. Hinchey*, 22 Tort & Ins. L.J. at 149)(enumerating a host of factors considered by courts in determining whether the surety has performed or settled in good faith).

The Oregon Court of Appeals concluded the scope of a surety's duties included reasonable investigation of the claims against the principal; the burden of proof, and consideration of the viability of claims, counterclaims and defenses:

Parties to an indemnity agreement which subjects the right to compromise a claim against the principal to the sole discretion of the surety must reasonably expect that

compromise and payment will be made only after reasonable investigation of the claims, counterclaims and defenses asserted in the underlying action. In order to prove lack of good faith in settling the claim, Management and the Wards ***needed only prove that Amwest failed to make reasonable investigation of the validity of the claims against them or to consider reasonably the viability of their counterclaims and defenses***, not that Amwest acted for dishonest purposes or improper motives.

City of Portland, 89 Or. App. at 458, 750 P.2d at 175 (emphasis supplied).

Further in Kansas, “[i]t is recognized that “the surety’s investigation is ‘standard practice’ in the industry [***] Hartford did not conduct a thorough investigation. Hartford simply paid the claims and sought indemnification.” *Hartford v. Tanner*, 22 Kan. App.2d 64, 76, 910 P.2d 872, 880-881 (1996). Here the Washington Administrative Code states that “Refusing to pay claims without conducting a reasonable investigation” constitutes an “unfair methods of competition and unfair or deceptive acts or practices of the insurer in the business of insurance”WAC 284-30-330(4); see also WAC 284-30-320(7) (such regulations apply to “any contract of [***] suretyship”).

4. Wisteria Raises Genuine Issue of Fact of Failure to Conduct Reasonable Investigation

If refusing to pay a claim without first conducting a reasonable investigation is a factor to be considered under either standard as applied

to a surety, then what facts were raised on summary judgment and upon reconsideration, which raise a genuine issue for trial?

First, Wisteria stated it had compelling defenses to DNR's allegations, defenses which it explained this to Bond Safeguard and was pursuing resolution by terms of the contract with DNR. *See* CP 164:20-165:15; *see also*, CP 108, 148-149 (letters from Wisteria to Bond Safeguard stating it had defenses and objecting to settlement). DNR refused any demand at dispute resolution, making no mention of the contract requirements for a formal hearing before him. CP 147, 158. Wisteria also argued further a reasonable investigation had not occurred. *Id.*; *see also*, CP 167-246 (exhibits L and Z to Declaration of Paul Friedrich)(e.g., in exhibit Z "1/26/07 [***] will be contacting Wisteria's attorney to gather information for Bond Safeguard's investigation" "3/20/07 [***] // It's been almost 2 months since Maas [Attorney for Bond Safeguard] claimed to be investigating" "04/04/07 [***] // nothing done re investigation // only thing Maas had was email from Wisteria"); *c.f.*, CP 131- 147. Wisteria then stated that "Bond Safeguard settled the claims to protect itself from regulatory sanctions calculating that it could demand reimbursement from Wisteria later." CP 165:20-23. This fact and inferences therefrom are not in dispute. *See* CP 253:11-21.

On motion for reconsideration, Wisteria's counsel provided additional argument that the complaint made by DNR to the Insurance Commissioners was due to Bond Safeguard's failure to make a timely, thorough investigation (using the existing record, exhibit L of Decl. of Paul Friedrich); therein specifically:

It is obvious that Bond Safeguard has either: (1) not adopted standards for prompt investigation of claims; (2) has adopted inadequate standards; or (3) has adopted adequate standards but failed to follow them. Bond Safeguard did not provide any reasonable explanation for its failure to promptly investigate. Only once did the claims department (Diaz) contact DNR on this claim and that was merely to request additional information. After hearing nothing on this claim for over 2 months after responding to Diaz' request, DNT had its attorney contact Bond Safeguard's attorney to determine why the claim had not been paid.

See CP 167-246 (exhibit L of Dec. of Paul Friedrich).

Further evidence and argument was made showing Bond Safeguard lacked independent knowledge about the case. *See* CP 55:20-56:7; CP 80-83 (Letter from Diaz to DNR, email from Maas to Marcus).

Here, a genuine issue of fact was raised regarding a factor of either unreasonable or bad faith settlement due to a surety's failure to investigate because: Wisteria provided knowledge of Wisteria's defense to the claims, lack of Bond Safeguard's activity in investigating and that the motivation by Bond Safeguard was to protect itself from regulatory sanctions. These

facts raised a genuine issue of material fact. Further, Wisteria provided further argument that the Insurance Commissioner's complaint was based on DNR's perception of a lack of investigation and two exhibits showed lacked independent knowledge.

V. CONCLUSION

For the aforementioned reasons, this Court should: (1) rule with regard to the standard of care for surety in Washington regarding a protested claim; (2) reverse the Superior Courts order granting summary judgment in favor of Bond Safeguard; and, (3) reverse the Superior Court's order denying Wisteria's motion for reconsideration.

Respectfully submitted this 9th day of April, 2012 at Arlington,
WA.

By



Scott Stafne, WSBA #6964
Andrew Krawczyk, WSBA #42982