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NO. 65734-8-1

COURT OF APPEALS STATE OF WASHINGTON
DIVISION I

ALBERT L. DYKES, an individual and former General Managing Partner
of Woodinville Business Center No. 1, and MARGARET RYAN-
DYKES, an individual and the marital community comprised thereof,

Appellants,

v.

WOODINVILLE BUSINESS CENTER NO. 1, a Washington Limited
Partnership,

Respondent.

OPENING BRIEF OF APPELLANTS ALBERT L. DYKES AND
MARGARET RYAN-DYKES

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I. INTRODUCTION

This is an indemnity action for reimbursement brought by a partnership against its former managing general partner, who was found liable for breach of a construction contract in 2007 — along with the partnership — to one of the other general partners of the same partnership and his separate construction company.

The partnership, Woodinville Business Center No. 1 (“the Partnership” or “WBC”), was created to develop and manage a parcel of land, specifically with the construction of multiple commercial buildings. Appellant Albert L. Dykes, the former Managing General Partner of that partnership, disputed that a Proposal Summary circulated to prospective investors constituted a binding construction contract with Lumpkin, Inc., the construction company owned and operated by Dykes’s co-partner Ned Lumpkin. The trial court in 2007 disagreed with Dykes and concluded that a valid contract existed, giving third party beneficiary rights to Lumpkin, Inc., and that Dykes breached the contract, and also his fiduciary duty to Lumpkin by deliberately concealing material information from Lumpkin in seeking other construction bids. Damages were imposed for breach of contract and fiduciary duty, which were paid to Lumpkin and Lumpkin, Inc. by WBC.

WBC, now with Lumpkin acting as the General Managing Partner,

brought suit against Dykes¹ in 2009, seeking indemnification for the monies paid to Lumpkin and Lumpkin, Inc. under the theory that the Partnership was damaged by Dykes's willful and retaliatory actions, which allegedly constituted a breach of the duty of loyalty, due care, good faith, and fair dealing to Lumpkin. The trial court in 2010 agreed with WBC and granted WBC's Motion For Summary Judgment for the claim of indemnity. The trial court ordered Dykes to reimburse WBC for the principal judgment it paid on behalf of Dykes, including over \$100,000 in attorney fees Dykes and WBC incurred in Dykes's defense and subsequent appeal. The trial court also awarded WBC over \$25,000 in attorney fees and costs incurred in the reimbursement action.

There was no basis for either imposition of attorney fees as consequential damages to WBC, nor was one provided by the trial court. Washington courts follow the "American Rule," whereby prevailing parties are not entitled to their attorney fees in absence of a contractual provision, statute, or a showing that a recognized equitable ground should apply. There is no contract or statute that provided a basis for the imposition of any attorney fees against Dykes. The only potential

¹ For clarity, the action in 2009 was brought against Appellant Albert L. Dykes and his wife, Appellant Margaret Ryan-Dykes. Since Ryan-Dykes is involved in this matter only as a member of the marital community, and had no substantive involvement in any of the matters in this case, "Dykes" hereinafter will only refer to Albert L. Dykes, as will "Appellant."

justification for the award of fees expended by WBC in defending its former managing general partner Dykes in the underlying matter is in equity, under the theory of equitable indemnity.

This exception to the American Rule cannot apply here, however, because there was no showing by WBC, or finding or conclusion by either trial court, that Dykes committed a wrong or omission against WBC, that WBC was solely involved in litigation with Lumpkin and Lumpkin, Inc. because of Dykes's wrongful conduct against WBC, supposedly motivated only by personal animus against Lumpkin, and that Lumpkin and Lumpkin, Inc. are total strangers to the original conduct that gave rise to the original suit. There can be no equitable indemnity for attorney fees without all three elements being shown by WBC.

Moreover, the imposition of attorney fees against Dykes in the indemnification matter, also not based in contract or statute, was instead based on the court's "inherent authority" to impose fees for a breach of fiduciary duty. However, the trial court exceeded such authority because those fees were imposed under holdings from case law that the appellate courts have repeatedly limited in scope, and even if still good law, cannot apply to this case.

Both of these awards of attorney fees by the trial court were therefore in error, and must be reversed by this Court.

II. ASSIGNMENTS OF ERROR

Assignments of Error

1. The trial erred in reimbursing Woodinville Business Center No. 1 the attorney fees incurred by Dykes and WBC in the breach-of-contract matter against Lumpkin and Lumpkin, Inc.

2. The trial court erred in awarding Woodinville Business Center No. 1 the attorney fees incurred by WBC in bringing its indemnification action against Dykes.

Issues Pertaining to Assignments of Error

1. Whether the trial court erred in awarding Woodinville Business Center No. 1 the attorney fees incurred by Dykes and WBC in the breach of contact matter, where:

- (a) WBC made no showing that Dykes committed any wrongdoing or omission to WBC, or a breach of fiduciary duty to WBC, and could not, and when Dykes's business decision to seek lower construction bids was protected by the business judgment rule;
- (b) WBC made no showing that the sole reason WBC was involved in litigation with Lumpkin and Lumpkin, Inc. was the supposed personal animus between Dykes and Lumpkin, which was the supposed cause of the breach of contract, and could not, because the original dispute centered on a legitimate legal question about

existence of a binding construction contract; and

- (c) WBC made no showing that Lumpkin and Lumpkin, Inc. are total strangers to the supposed wrongful conduct by Dykes, and could not, because they were both parties to the original action against WBC and Dykes, Lumpkin was a General Partner to WBC at the time of the conduct by Dykes and benefitted from said conduct, and Lumpkin was actively involved in the bidding dispute that led to Dykes's breach of contract with Lumpkin, Inc.

2. Whether the trial court erred in awarding Woodinville Business Center No. 1 its attorney fees incurred by WBC in bringing its indemnification action against Dykes, where:

- (a) the "American Rule" precludes awarding attorney fees to a prevailing party in the absence of a statutory, contractual, or equitable basis;
- (b) the case law cited by WBC as justification for an award of fees under a court's "inherent authority" has been severely limited by later case law, and is inapplicable here even if still good law; and
- (c) the award of fees to WBC for the indemnification matter is better characterized as a punitive damage award, which is prohibited by Washington law.

III. STATEMENT OF THE CASE

A. **Dykes exercises authority as Managing General Partner of WBC to negotiate and execute construction contracts**

In 1980, Dykes, Lumpkin, and John Kloster formed Woodinville Business Center No. 1, a limited partnership. CP 18. The purpose of WBC was to:

invest in, finance the acquisition of, purchase, own, improve, develop, operate, manage and maintain for any uses, and to sell or trade a warehouse/office complex of approximately 80,000 square feet and related land and improvements [.]

CP 18, 66. Dykes and Kloster were delegated to attract investors to fund the Project's development in Woodinville; Lumpkin, a general contractor, was to provide construction services. CP 18. Dykes was made the Managing General Partner for WBC; under the terms of the Partnership Agreement, all general partners had the power to "acquire, manage, and control the Partnership assets and business and in exercising such exclusive right and duty, shall in their absolute discretion have the power on behalf of the Partnership" to sell or convey title of property held by the partnership, employ firms or corporations in the operation and management of the partnership property, improve the partnership property, and to execute "any and all instruments to effectuate the forgoing." CP 19, 69-70.

The Partnership Agreement further stated

By way of extension of the foregoing and not in limitation thereof, general partners shall possess all of the powers and rights of the partners in a partnership without limited partners under the general partnership law of the State of Washington.

CP 69-70.

To attract investors for the Project, WBC circulated a Proposal Summary setting forth the details of the Project. CP 19, 101-13. According to the Proposal Summary, the Project was to be completed in five phases. Phase I was to consist of architectural and engineering planning. CP 101. Phase II was to be site development and the construction of the first building. *Id.* Phases III-IV would include the construction of three additional buildings. CP 101, 108. The Proposal Summary stated that Lumpkin, Inc. would act as the general contractor in the construction of the Project. CP 103-04.

The first two buildings for the Project were constructed at the Project site relatively quickly after the Partnership garnered enough financial support. CP 20.

However, Dykes, who has extensive experience in acquisition and development, had come to believe that Lumpkin, Inc. had over-billed the Partnership for its work on the Project. CP 286-87.

By 2003, the partnership was ready to begin construction on the

third and fourth buildings on the Project site. CP 20. Dykes hired MRJ Construction to review the plans for Buildings 3 and 4 and to also provide engineering services. CP 20. In June 2003, MRJ made a preliminary proposal to perform the remaining construction for \$1,754,519, and later made a formal bid in August of the same year, but for \$1,632,307 (including a 5% contractor fee). CP 20-21. MRJ later proposed a revised bid on August 18, 2003, this time for \$1,619,082. CP 21.

Lumpkin, and his company, Lumpkin, Inc., were not made aware of the bids by MRJ. CP 21. Lumpkin and Dykes had had a falling out because of some unrelated business matters. CP 20. In early September 2003, Dykes provided the current plans and specifications for Buildings 3 and 4, and gave Lumpkin “an invitation to bid on the project.” CP 21. Lumpkin believed that under the terms of the Partnership Agreement, he did not need to bid on any part of the Project, but that the Partnership was obligated to have his company provide the construction services; however, he submitted an estimate on October 15, 2003 for the construction of Buildings 3 and 4. CP 21. The estimate provided by Lumpkin, Inc. was \$1,714,000, which included a 10% general contractor’s fee. CP 21.

Dykes hired architect Mark Travers in the Spring of 2004 to act as an intermediary between the two bids already made by Lumpkin, Inc. and MRJ. CP 22. Travers decided that the best solution was to solicit new

bids. CP 22. However, Travers contacted two contractors without informing Lumpkin. CP 22. Lumpkin nonetheless found out about these events, and it was agreed that Lumpkin could submit an updated bid. CP 22. The revised Lumpkin estimate increased to \$1,882,000. CP 22-23.

On August 19, 2004, Dykes, upon the advice of Travers, decided to accept the bid from MRJ to construct Buildings 3 and 4. CP 24. The price of the final contract was \$1,720,556. CP 24.

B. Lumpkin and Lumpkin, Inc., sued WBC and Dykes for breach of contract.

On October 12, 2005, Lumpkin and Lumpkin, Inc. filed an action against WBC and Dykes, claiming breach of contract under the Partnership Agreement, King County Cause No. 05-2-33756-7 SEA. CP 318-320. After a three-day bench trial between April 9 and April 11, 2007, the Honorable William L. Downing ruled in favor of plaintiffs Lumpkin and Lumpkin, Inc. CP 17-27.

The trial court found (1) that Lumpkin, Inc. was an intended third party beneficiary of the Proposal Summary for the Project and that that contract gave it the “contractual right to perform specified construction services and to be compensated for that work”; (2) that that contract was breached “when Lumpkin, Inc. was denied the opportunity to construct buildings 3 and 4 and to be compensated for this work at the agreed upon

rate”; and (3) that Dykes breached his fiduciary duty to his partner Lumpkin by concealing material information from him “rather than according him the full candor and good faith dealing that were required.” CP 15, 26-27.

On May 18, 2007, the trial court entered judgment in favor of Lumpkin and Lumpkin, Inc.; the principal amount awarded to Lumpkin and Lumpkin, Inc. was \$188,100.00, \$60,480.59 in prejudgment interest, \$4,746.87 in costs, and \$0 in attorney fees, for a total of \$253,327.46. CP 14-15, 137-38.

Dykes appealed the trial court’s rulings, but was unsuccessful. *See Lumpkin, Inc. v. Woodinville Business Center No. 1*, 145 Wn. App. 1049, *2, ___ P.3d ___ (2008) (this court affirming trial court rulings in an unpublished opinion).² Dykes petitioned the Washington Supreme Court for review, but was denied on March 3, 2009. *Lumpkin Inc. v. Woodinville Business Ctr. No. 1*, 165 Wn.2d 1028, 203 P.3d 378 (2009).

WBC then paid the judgment to Lumpkin, Inc., in the sum total of \$310,094.79 for the principal amount and costs on or about March 24, 2009. CP 49-50.

² Appellants cite this unpublished opinion only for the purposes of providing background facts, and not for precedential authority. *See* RCW 2.06.040.

C. WBC sued Dykes for indemnity.

Less than a year after this court issued its unpublished opinion, on June 23, 2009, WBC — with Lumpkin now acting as its managing general partner — brought the immediate cause of action against Dykes for indemnity, seeking reimbursement from Dykes to WBC; specifically, WBC sought the funds which paid the judgment to Lumpkin, Inc., including the attorney fees Dykes and WBC expended in Dykes’s defense. CP 5-13, 322, 392-400. WBC alleged claims for (1) indemnity, CP 6-9; (2) breach of fiduciary duty, CP 10; (3) breach of contract, CP 10-11; and (4) contribution, CP 11-12.

In the complaint’s prayer for relief, WBC also sought “Plaintiff’s attorney fees and other costs pursuant to all applicable laws and applicable remedies, including but not limited to the Partnership’s agreement(s) and applicable case law, *Li v. Tang*, 87 Wn.2d 796, 557 P.2d 342 (1976); *Green v. McAllister*, 103 Wn. App. 452, 13 P.3d 795 (2000).” CP 12.

On February 25, 2010, WBC filed its Motion For Summary Judgment, arguing (1) that the underlying action established that Dykes breached his fiduciary duty to Lumpkin, CP 52-53; (2) that WBC was entitled to indemnity for Dykes’ violation of statutory duties and is also entitled to equitable indemnity, CP 53-56; (3) that reimbursement to WBC was required because Dykes would otherwise be unjustly enriched, CP 56-

57; and (4) that WBC was entitled to its attorney fees and costs in the reimbursement action under *Tang and Green, supra*, as well as prejudgment interest. CP 58-59.

For attorney fees, WBC requested reimbursement of \$8,680.05 for the work of Phil Talmadge and \$88,851.82 for the work of John Sherwood, and also sought reimbursement of \$14,296.10 for the fees incurred for the work of Travers, the architect who acted as a consultant to negotiate the bids between Lumpkin, Inc. and MRJ.³ CP 167.

A hearing for the summary judgment motion was heard before the Honorable Carol A. Schapira on March 26, 2010. CP 350. After hearing oral argument, Judge Schapira granted summary judgment for WBC for the indemnity claim and decided to hold a later hearing to determine the reasonableness of the claimed attorney fees. CP 350-51; CP 352-53 (Order Granting WBC MSJ).

After the hearing on fees on June 18, 2010, the trial court entered its Order Granting Plaintiff's Motion Determining Reasonable Attorney Fees and for Entry of Final Judgment ("Order on Fees"), ruling that \$25,821.50 in attorney fees for WBC bringing the reimbursement action was reasonable. CP 471, ¶ 3. On the same day, the trial court entered its

³ WBC later waived its claim for Travers's fees. CP 472, ¶ 6.

Judgment. CP 464-66. The Judgment established the principal judgment amount against Dykes to be \$407,626.66, prejudgment interest to be \$84,050.52, and attorney fees in that action to be \$25,821.50. CP 465.

Dykes filed his Notice of Appeal on July 15, 2010. CP 467-68.

IV. SUMMARY OF ARGUMENT

The trial court erred in awarding attorney fees to WBC as reimbursement for the attorney fees incurred by Dykes and WBC in the underlying breach-of-contract matter because (1) WBC made no showing that Dykes committed any wrongdoing or omission to WBC, or a breach of fiduciary duty to WBC, and could not, and when Dykes's business decision to seek lower construction bids was protected by the business judgment rule; (2) WBC made no showing that the sole reason WBC was involved in litigation with Lumpkin and Lumpkin, Inc. was the supposed personal animus between Dykes and Lumpkin, which was the supposed cause of the breach of contract, and could not, because the original dispute centered on a legitimate legal question about existence of a binding construction contract; and (3) WBC made no showing that Lumpkin and Lumpkin, Inc. are total strangers to the supposed wrongful conduct by Dykes, and could not, because they were both parties to the original action against WBC and Dykes, Lumpkin was a General Partner to WBC at the time of the conduct by Dykes and benefitted by said conduct, and

Lumpkin was actively involved in the bidding dispute that led to Dykes's and WBC's breach of contract with Lumpkin, Inc.

Further, the trial court erred in awarding WBC its attorney fees incurred for bringing its indemnity action, because (1) the "American Rule" precludes awarding attorney fees to a prevailing party in the absence of a statutory, contractual, or equitable basis; (2) the case law cited by WBC as justification for an award of fees under a court's "inherent authority" has been severely limited by later case law, and is inapplicable here even if still good law; and (3) the award of fees to WBC for the indemnification matter is better characterized as an award of punitive damages, which Washington law prohibits.

V. LEGAL AUTHORITY AND ARGUMENT

A. **WBC was not entitled to an award of attorney fees incurred by Dykes and WBC as consequential damages under any applicable equitable theory.**

In general, Washington follows the "American Rule" as to the recovery of attorney fees for a prevailing party in a cause of action. "In absence of contract, statute or recognized ground of equity, a court has no power to award an attorney's fee as part of the costs of litigation." *Armstrong Const. Co. v. Thomson*, 64 Wn.2d 191, 195, 390 P.2d 976 (1964) (citation and internal quotations omitted); *see also Rorvig v. Douglas*, 123 Wn.2d 854, 861, 873 P.2d 492 (1994) (citations omitted);

ASARCO Inc. v. Air Quality Coalition, 92 Wn.2d 685, 715, 601 P.2d 501 (1979); *Brougham v. Swarva*, 34 Wn. App. 68, 72, 661 P.2d 138 (1983) (citations omitted). “[A] more accurate statement of Washington’s American rule is attorney fees are not available as *costs or damages* absent a contract, statute, or recognized ground in equity.” *City of Seattle v. McCready*, 131 Wn.2d 266, 275, 931 P.2d 156 (1997) (emphasis in original).

Here, WBC moved the court for reimbursement under two theories: equitable indemnity and unjust enrichment. CP 53-57. The trial court granted WBC’s summary judgment only on the indemnity claim. CP 353. Therefore, because there was no contractual or statutory basis for the reimbursement of WBC’s fees incurred for the underlying action, the trial court’s decision was not in error **only** if there is an applicable equitable basis for the award, and **only** if WBC made the requisite showing that it was entitled to the award under that basis.

- 1. To be entitled to equitable indemnity, WBC was required to show three elements that it failed to prove here.**

Where there is no statutory or contractual basis for an award of reasonable attorney fees or costs, Washington courts recognize that such awards may be granted under the traditional equitable grounds. *See Blue Sky Advocates v. State*, 107 Wn.2d 112, 122, 727 P.2d 644 (1986) (citation

omitted). These grounds include: (1) bad faith; (2) preservation of a common fund; (3) protection of constitutional integrity; and for (4) private attorney general actions. *See Pub. Util. Dist. No. 1 v. Kottsick*, 86 Wn.2d 388, 390-91, 545 P.2d 1 (1976); *see also McCready*, 131 Wn.2d at 274-75; *Miotke v. City of Spokane*, 101 Wn.2d 307, 338-41, 678 P.2d 803 (1984), *overruled on other grounds*, *Blue Sky*, 107 Wn.2d 112 (rejecting private attorney general basis).

Additionally, Washington courts recognize that attorney fees may be a proper element of consequential damages under the theory of “equitable indemnity”:

[w]here the acts or omissions of a party to an agreement or event have exposed one to litigation by third-persons — that is, to suit by persons not connected with the initial transaction or event[.]

Armstrong, 64 Wn.2d at 195 (citations omitted); *see also Haner v. Quincy Farm Chemicals, Inc.*, 97 Wn.2d 753, 757, 649 P.2d 828 (1982) (citation omitted); *Wells v. Aetna Ins. Co.*, 60 Wn.2d 880, 882, 376 P.2d 644 (1964). Generally, “indemnity” refers to reimbursement, and a separate action in equity may lie “when one party discharges a liability which another should rightfully have assumed.” *Central Wash. Refrigeration, Inc. v. Barbee*, 133 Wn.2d 509, 513, 946 P.2d 760 (1997).

Washington case law has established that there are three elements

that must be shown for a party to be entitled to attorney fees as consequential damages in equity — also known as the “ABC Rule”:

- (1) a wrongful act or omission by A toward B; (2) such act or omission exposes or involves B in litigation with C; and
- (3) C was not connected with the initial transaction or event, the wrongful act or omission of A toward B.

Manning, 13 Wn. App. at 769. See, e.g., *Rogerson Hiller Corp. v. Port of Port Angeles*, 96 Wn. App. 918, 930, 982 P.2d 131 (1999); *Woodley v. Benson & McLaughlin, P.S.*, 79 Wn. App. 242, 246, 901 P.2d 1070 (1995) (citation omitted); *Tradewell Group, Inc. v. Mavis*, 71 Wn. App. 120, 126, 857 P.2d 1053 (1993) (citing *Manning*). This exception to the American Rule is narrowly applied, however, and is permitted only when the third party becomes involved in litigation through no fault of its own. See *Jain v. J.P. Morgan Sec., Inc.*, 142 Wn. App. 574, 587, 177 P.3d 117 review denied, 164 Wn.2d 1022, 196 P.3d 135 (2008), cert. denied, ___ U.S. ___, 129 S.Ct. 1584, 173 L.Ed.2d 676 (2009). To recover fees, the party claiming equitable indemnity must prove all three elements. See *Blueberry Place Homeowners Ass’n. v. Northward Homes*, 126 Wn. App. 352, 359, 110 P.3d 1145 (2005).

Further, the rule allows the wronged party to recover only its own fees incurred in the litigation with the third party, “not the attorney fees of the third person with whom the wronged party is drawn into litigation and

for which the wronged party may be held liable.” *Thomas v. Gaertner*, 56 Wn. App. 635, 638, 784 P.2d 575 (1990) (citing *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wn. App. 502, 523, 728 P.2d 597 (1986)). Also, “fees are not recoverable in **separate indemnity actions by the innocent defendant against the wrongdoer.**” *Brock v. Tarrant*, 57 Wn. App. 562, 572, 789 P.2d 112 (1990) (citation omitted) (emphasis added).

Whether or not a particular equitable theory authorizes such an award is a legal question for the appellate court, and is thus reviewed de novo. See *Deep Water Brewing, LLC v. Fairway Resources, Ltd.*, 152 Wn. App. 229, 277, 215 P.3d 990 (2009) (citing *Tradewell*, 71 Wn. App. at 126-27); see also *Rasmussen v. Bendotti*, 107 Wn. App. 947, 954-55, 29 P.3d 56 (2001) (questions of law reviewed de novo) (citations omitted). See also *Blueberry Place*, 126 Wn. App. at 359 (“The trial court’s decision that the elements of equitable indemnity are met and the ABC rule applies is a legal question subject to de novo review”) (citation omitted). Because attorney fees in this context are seen as consequential damages, and not as the costs of litigation, the amount of fees awarded is also reviewed de novo. See *Shoemaker v. Ferrer*, 168 Wn.2d 193, 198, 225 P.3d 990 (2010) (“Generally, the appropriate measure of damages for a given cause of action is a question of law, reviewed de novo”) (citation and internal quotations omitted). Thus, this Court has no obligation to pay

deference to any conclusion by the trial court. *See In re Marriage of Lemke*, 120 Wn. App. 536, 541 n.12, 85 P.3d 966 (2004).

In light of the above, in order for the trial court's determination that WBC should be reimbursed under a theory of equitable indemnity to not be in error, all three elements of the "ABC Rule" must have been shown by WBC, and supported by the record before the court. *See Blueberry Place*, 126 Wn. App. at 359.

2. Because Dykes did not commit a wrongful act against WBC, the ABC Rule does not apply.

Within the context of the "ABC Rule," "A" is Dykes (the supposed wrongdoer), "B" is WBC (the wronged party that was exposed to litigation solely because of Dykes's wrongdoing), and "C" is Lumpkin and Lumpkin, Inc. (the "third party" that sued the wronged party).

The threshold element a party must show to be entitled to equitable indemnity is that "A" actually committed a wrong or omission against it.

The court in *Manning* articulated the first element of the ABC rule:

The Washington decisions discussing [the ABC] rule do not clearly state that the original act or omission must be against B, **but such is clearly implied**. All of the Washington cases allowing expenses of litigation to be recovered as consequential damages involve a breach of duty by A which exposed B to litigation to C, a third person who was a stranger to the event involving A and B.

13 Wn. App. at 769 (emphasis added); *see also Dauphin v. Smith*, 42 Wn. App. 491498, 713 P.2d 116 (1986) (first element of ABC Rule not met

because conduct of subsequent purchaser of property against vendor “was not wrongful.”). Indeed, in the few cases where the ABC Rule was met, “A” committed a wrongful act or omission against “B.” *See, e.g., Broten v. May*, 49 Wn. App. 564, 571-72, 744 P.2d 1085 (1987); *Aldrich & Hedman, Inc. v. Blakely*, 31 Wn. App. 16, 20, 639 P.2d 235 (1982).

Here, WBC made no showing before the trial court that Dykes committed any wrongful act or omission against WBC, nor did the trial court conclude that such conduct occurred, nor did the trial court in the underlying breach-of-contract action. Further, there was no breach of a fiduciary duty to WBC by Dykes, nor did either trial conclude to the contrary. The reality is, there could be no such showing under the facts of this case and the applicable law.

A general partner has the fiduciary duty of loyalty and care to the entity and the limited partners. *See Bassan v. Inv. Exch. Corp.*, 83 Wn.2d 922, 925-26, 524 P.2d 233 (1974). The fiduciary duties owed by a general partner to a limited partnership and its limited partners are defined by the law governing partnerships, RCW 25.05. RCW 25.05.165 “General Standards of Partner’s Conduct” provides:

- (1) The only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and the duty of care set forth in subsections (2) and (3) of this section.

(2) A partner's duty of loyalty to the partnership and the other partners is limited to the following:

(a) To account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property, including the appropriation of a partnership opportunity;

(b) To refrain from dealing with the partnership in the conduct or winding up of the partnership business as or on behalf of a party having an interest adverse to the partnership; and

(c) To refrain from competing with the partnership and the conduct of the partnership business before the dissolution of the partnership;

(3) A partner's duty of care to the partnership and the other partners in the conduct and winding up of the partnership business is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law.

(4) A partner does not violate a duty or obligation under this chapter or under the partnership agreement merely because the partner's conduct furthers the partner's own interest.

RCW 25.05.165.

In *J&J Celcom v. AT&T Wireless Servs., Inc.*, 162 Wn.2d 102, 169 P.3d 823 (2007), the Washington Supreme Court addressed a certified question from the United State Court of Appeals for the Ninth Circuit regarding the duty of loyalty. The Court was asked to define the standard of care owed by a general partner to the partnership pursuant to its duty of

loyalty. *Id.* at 103. The Washington Supreme Court noted that consistent with its holdings in *Karle v. Seder*, 35 Wn.2d 542, 214 P.2d 684 (1950), and *Bassan*, 83 Wn.2d 922, a general partner's duty of loyalty requires that the general partner disclose all material information to the partnership. *J&J Celcom*, 162 Wn.2d at 107.

Writing in a separate concurrence, Justice Madsen addressed each of the three duties of loyalty described in RCW 25.05.165(a)-(c). *Id.* at 108-15. In describing the scope of a partner's fiduciary duties to a partnership under RUPA, Justice Madsen wrote:

RUPA represents a major overhaul in the nature of the fiduciary duties imposed on partners. There are two general views of the partnership relation: one emphasizes the fiduciary nature of the relationship and the other emphasizes the contractual nature of the relationship.² The common law and UPA are based on the fiduciary view, the fundamental principle of which is that partners must subordinate their own interests to the collective interest, absent consent of all the partners. Thus, under the common law and UPA, the duty of loyalty prevented a partner from benefiting, directly or indirectly, from the partnership, more than any of the other partners. The broad approach from the Restatement of Agency, incorporated into partnership law, was that the duty of loyalty required a partner to act solely for the benefit of the partnership in all matters connected to the partnership. This required partners to disgorge any profits made without consent of the other partners, the rule applied in *Bassan*.

RUPA represents a major shift away from the fiduciary view and toward the "libertarian" or "contractarian" view, by (a) expressly limiting fiduciary duties, (b) sanctioning a partner's pursuit of self-interest, and (c) allowing partners

to waive most fiduciary duties by contract. RUPA was intended to bring the law of partnership into the “modern age,” to make partnerships more rational, efficient, and stable business entities.

Id. at 109-10 (Madsen, J. concurring). In light of the sea-change to partnership law implemented by RUPA as to the duties owed to the partnership and the other partners, there could be no finding or conclusion that Dykes breached any duty to WBC, nor was there such a finding. In fact, despite bringing a cause of action for breach of fiduciary duty, *see* CP 10, WBC moved for summary judgment only on the equitable indemnity and unjust enrichment theories. CP 53-57. The trial court granted WBC’s summary judgment on the indemnification grounds, and never decided, or was asked to decide by WBC, the breach of fiduciary duty claim. CP 353.

Moreover, Dykes’s conduct was protected by the business judgment rule, and thus could not serve as a basis for the trial court to find a wrongdoing by Dykes or a breach of any duty to the Partnership. Washington courts “review business decisions under the business judgment rule and infrequently reverse a business decision.” *See Lane v. City of Seattle*, 164 Wn.2d 875, 882, 194 P.3d 977 (2008) (citation omitted).

Under the ‘business judgment rule,’ corporate management is immunized from liability in a corporate transaction where (1) the decision to undertake the transaction is within the power of the corporation and the authority of

management, and (2) there is a reasonable basis to indicate that the transaction was made in good faith.

Durand v. HIMC Corp., 151 Wn. App. 818, 836, 214 189 (2009) (citation omitted). Courts are reluctant to interfere with the internal management of corporations and generally refuse to substitute their judgment for that of the directors. See *In re Concrete Prod., Inc.*, 126 Wn.2d 269, 279, 892 P.2d 98 (1995). Neither the directors nor the other officers of a corporation are liable for mere mistakes or errors of judgment, either of law or fact. See *Schwarzmann v. Assn. of Apt. Owners*, 33 Wn. App. 397, 402, 655 P.2d 1177 (1982) (quotations and citation omitted). The business judgment rule also protects officers even if the mistake “may be so gross that [it] may demonstrate the unfitness of the directors to manage the corporate affairs.” *Id.* Therefore, the ordinary standard of care under agency law, *i.e.* acting with reasonable skill and ordinary due care and diligence, is supplanted by the business judgment rule, which requires the officer to only act with good faith and without “corrupt motive.” *Para-Medical Leasing v. Hangen*, 48 Wn. App. 389, 396, 739 P.2d 717 (1987).

In the underlying breach-of-contract action, Dykes testified that he believed all of his actions were justified and were objectively in the best financial interests of the Partnership. As the General Managing Partner, and with authority to manage Partnership assets and make executive

decisions, he believed in good faith — and on the advice of counsel — that the Proposal Summary was not a binding contract with Lumpkin, Inc., and actively sought bids for the remaining construction projects for a substantially lower amount than that estimated by Lumpkin, Inc. While the trial court focused on the personal animus between Dykes and Lumpkin as the primary motivation for Dykes’s attempts to seek outside bids from other firms than Lumpkin, Inc., this does not equate to a finding that Dykes’s actions were not in the best interest of the Partnership, as opposed to Lumpkin’s personal financial interests, or that such actions were not protected under the business judgment rule.

In other words, any supposed lack of good faith towards Lumpkin does not equate to a lack of good faith in Dykes’s actions seeking to maximize the financial benefit to the Partnership as a whole — which, coincidentally, also benefited General Partner Lumpkin by default. This is particularly true when the bid submitted by MRJ was substantially less than that of Lumpkin, Inc.’s. CP 21-24. The business judgment rule should have shielded Dykes from liability to Lumpkin and Lumpkin, Inc., but certainly as to Dykes’s actions towards WBC, the rule precluded the trial court from finding that he committed a “wrongdoing” or “omission” against WBC in the context of the ABC Rule.

More importantly, neither trial court ever concluded that Dykes

committed any wrongdoing or omission, or breached any fiduciary duty to WBC. *See* CP 17-27. This is dispositive as to whether the ABC Rule could have provided a basis for fees. Judge Downing determined that Dykes breached his fiduciary duty to **Lumpkin** by not honoring what the court concluded was a valid contract with Lumpkin, Inc. for the construction of Buildings 3 and 4. CP 25, 26-27. Specifically, the trial court concluded:

5. The contract was breached when Lumpkin, Inc. was denied the opportunity to construct buildings 3 and 4 and to be compensated for this work at the agreed upon rate.

6. As managing partner, Mr. Dykes had a fiduciary duty to his partner Ned Lumpkin. Knowing of Mr. Lumpkin's reasonable expectations under their agreement, **it was a breach of that fiduciary duty to conceal material information from him rather than according him the full candor and good faith dealing that were required.**

CP 27 (emphasis added).

Consistent with this, Judge Downing's judgment specifically states that Lumpkin and Lumpkin, Inc. are granted judgment against WBC and Dykes "for the damages arising out of the contract between the parties, Defendants' breach of such contract, and Defendant Albert L. Dykes' **breach of his fiduciary duty to Plaintiffs[.]**" CP 402 (emphasis added). There is no finding or conclusion that Dykes acted against WBC's interest.

Although WBC argued around this fact in its Motion for Summary Judgment in the indemnity action, repeatedly implying that Judge

Downing concluded that Dykes breached either the fiduciary duty of care or duty of loyalty to WBC, this did not occur. *See* CP 53-54. Applying the test of RCW 25.050.165 setting forth said duties, no court, not Judge Downing nor Judge Schapira, ever concluded that as to the Partnership, Dykes conduct was “grossly negligent,” or that he engaged in “reckless conduct” or any “intentional misconduct” as to the Partnership. WBC’s use of inflammatory language such as “wrongfully attempting to withhold monies”, “intentionally excluded Lumpkin, Inc.”, “motivated by personal animosity”, etc., *see* CP 54, certainly makes it appear that the first trial court found some kind of wrongful conduct to the Partnership by Dykes, but this implication is not supported by the record.

The failure to find a wrongful act or breach of a duty to WBC makes sense here because Lumpkin and Lumpkin, Inc. did not even allege such conduct against Dykes or WBC in their original complaint. CP 320 (suing for “Breach of Agreement”). In other words, the issue was not even litigated before the first trial court.

This is dispositive as to the first element of the ABC Rule because Judge Schapira, who relied only on the previous court’s findings of fact and conclusions of law in awarding reimbursement to WBC under an equitable indemnity theory, had no basis to award fees under the ABC Rule because the first element could not be found. *See Manning*, 13 Wn.

App. at 769. Her order granting WBC's summary judgment, additionally, is totally silent on the issue and contains no findings of any wrongdoing against WBC by Dykes — who were **co-defendants** in Lumpkin's original action. CP 470.

Therefore, the trial court ordering Dykes to reimburse WBC attorney fees for the breach-of-contract action when WBC made no showing that Dykes committed any wrongdoing or omission, breach of fiduciary duty, and when Dykes's business decisions were protected by the business judgment rule was reversible error.

3. Because Dykes's conduct was not the only cause of WBC's exposure to litigation to Lumpkin and Lumpkin, Inc., the ABC Rule does not apply.

Under the ABC Rule, the causal connection between "B"'s exposure to litigation to "C" and the wrongful act or omission of "A" must be "**an exceptionally close causal nexus**" that is "greater than in an ordinary tort action" in order for a party to be entitled to indemnification of attorney fees. *See Woodley*, 79 Wn. App. at 247-48 (emphasis added). Also, a party cannot be entitled to equitable indemnity "if, in addition to the wrongful act or omission of A, **there are other reasons why B became involved in litigation with C.**" *Tradewell*, 71 Wn. App. at 128 (emphasis added); *see also Blueberry Place*, 126 Wn. App. at 360-62.

If Party A's conduct **is not the only cause** of Party B's involvement in the litigation, and particularly if Party's B's own conduct contributed to Party B's exposure in the litigation, an action under [the ABC Rule] will not lie.

Woodley, 79 Wn. App. at 248 (citation omitted); *see also Jain*, 142 Wn. App. at 587 (no fees when there were other reasons B was exposed to litigation to C other than conduct of A); *Western Comm. Bank v. Helmer*, 48 Wn. App. 694, 701, 740 P.2d 359 (1987) (fees denied because court could not conclude that A's failure to B was the "sole reason" B was involved in litigation with C).

Indeed, proving that the second element of the ABC Rule is present is extraordinarily difficult, and the failure to do so is the reason many claims for indemnification of attorney fees are denied. *See, e.g., Jain*, 142 Wn. App. at 588; *Blueberry Place*, 126 Wn. App. at 359 (no fees for B when there were other causes for the action by C against B other than those caused by A's wrongful act); *Lyzanchuk v. Yakima Ranches Owners Ass'n, Phase II, Inc.*, 73 Wn. App. 1, 10-11, 866 P.2d 695 (1994) (no fees because B not "involuntarily exposed" to litigation solely due to A); *Haner*, 97 Wn.2d at 758; *Stoltz v. McKowen*, 14 Wn. App. 808, 813, 545 P.2d 584 (1976) (B exposed to litigation because C decided to sue it, not because A committed wrongful act against B). Even when there is a legitimate causal connection between the wrongful conduct of A to B and

the litigation between B and C, that is not sufficient. *Woodley*, 79 Wn. App. at 248 (no fees when connection between A's acts and B's legal expenses "[was] relatively weak").

Further, to show proximate cause under the ABC Rule, under the second element, "the expense of the prior litigation must have been **reasonably incurred**, that is, the prior litigation must have been conducted in good faith and with reasonable grounds to believe that it would have a successful outcome." *George v. Farmers Ins. Co. of Wash.*, 106 Wn. App. 430, 445, 23 P.3d 552 (2001) (citation omitted).⁴

Thus, to prove the second element, a party seeking equitable indemnification must show "cause in fact" as well as legal causation in terms of the alleged wrongdoing by A against B exposing B to litigation with C. *See Woodley*, 79 Wn. App. at 246-47.

In this action, WBC failed to prove this second element of the ABC Rule before the trial court, and could not have been proven if it had tried. First, WBC did not show, and the trial court did not find, that the **sole** reason WBC ("B") was involved in the cause of action against Lumpkin and Lumpkin, Inc. ("C") was the wrongful conduct — *i.e.* the breach of contract motivated by personal animus — of Dykes against

⁴ On this point, it does not appear that the attorney fees incurred in the breach of contract action were ever determined by the trial court to be reasonable.

Lumpkin. Without such an explicit determination, the second element of the ABC Rule could not have been met, and the attorney fee reimbursement to WBC cannot be supported. Specifically, to the extent the trial court wholly relied upon the findings of fact and conclusions of law in the breach-of-contract matter, the trial court never concluded that the only reason WBC was involved with the suit with Lumpkin and Lumpkin, Inc. was the actions of Dykes. CP 469-70.

Second, the facts of this case indicate that the personal animus against Lumpkin found by the trial court in the underlying action was not the sole cause of the breach of contract, and thus not the sole cause of why WBC became involved in the action with Lumpkin. Dykes already explained his legitimate motivations for his conduct in favor of the Partnership in both the briefing below, and in previous sections of this Brief. *See* CP 21-22. Dykes contends that the trial court in the breach-of-contract-matter made multiple erroneous conclusions related to this, which this court affirmed, and is appropriately not challenging any of those findings or conclusions here.

However, within the context of the second element of the equitable indemnity test, the presence of legitimate reasons why Dykes acted in the manner that he did precludes this court from concluding that the “sole” reason for WBC’s involvement in a suit with Lumpkin and Lumpkin, Inc.

was the personal animus towards Lumpkin that caused the breach of fiduciary duty. Specifically, there was a legitimate legal question as to whether the Proposal Summary constituted a permanent contract for all projects for the Partnership; enough of a question, in fact, to justify a three-day trial. CP 17. *See Tradewell*, 71 Wn. App. at 128-29 (reversing award of fees to B because existence of a valid agreement was additional reason C sued B and A, not just actions of A towards B). In other words, Dykes's wrongful conduct was the breach of a fiduciary duty to Lumpkin, which is not why Lumpkin and Lumpkin, Inc. sued Dykes and WBC.

Additionally, even absent any animus, Lumpkin and Lumpkin, Inc. almost certainly still would have sued Dykes and WBC had Dykes decided that it made more business sense to give the construction contract to a lower-priced bid from a separate company under exactly the same theory of breach-of-contract. The causal connection between the personal animus toward Lumpkin thus cannot meet the stringent nexus to the suit between Lumpkin and WBC as defined in *Woodley* when there were legitimate legal issues as to the existence and validity of a binding contract that also contributed to the conduct that was later determined to be a breach. CP 21-22, 26; *Woodley*, 79 Wn. App. at 247-48.

Third, the reality is that Lumpkin and Lumpkin, Inc. voluntarily chose to sue WBC for breach-of-contract — that is the primary reason

WBC was involved in any litigation at all. CP 318. There was no requirement that Lumpkin sue WBC, his own partnership, as opposed to only Dykes. In other words, the central reason WBC is suing Dykes in the immediate suit is for reimbursement for the fees incurred from the suit Lumpkin and Lumpkin, Inc. **chose to initiate against WBC.** Since Lumpkin is now the General Managing Partner of WBC, he is essentially seeking to reimburse the Partnership for the judgment paid out to his own company.

The facts of *Stoltz* are instructive, as is the holding. In *Stoltz*, the plaintiff was injured in a head-on collision with a Ford truck owned by Sani-Safe and driven by one its agents. *Stoltz*, 14 Wn. App. at 808-09. *Stoltz*, the plaintiff, brought an action against the agent, Sani-Safe, and Ford. There were allegations of faulty manufacturing against Ford. The trial court granted judgment against Sani-Safe and its driver, but denied recovery from Ford. *Id.* at 809. Ford sought attorney fees against Sani-Safe, but was denied. All defendants appealed the trial court's decisions.

The *Stoltz* court concluded that the *Manning/ABC* rule **would** have applied if Ford had been solely responsible for plaintiff's injuries. Specifically, in such a scenario, Sani-Safe and its agent could have sought fees from Ford under equitable indemnification because Ford's wrongful act in supplying the defective product in question would have exposed

Sani-Safe to litigation. *Id.* at 812. However, under the facts of that case, the negligence attributed to Sani-Safe was “not the breach of any legal duty owed to Ford, but only to plaintiff.” *Id.* at 812. The court concluded that Ford was exposed to the lawsuit in the first place only because plaintiff chose to sue it along with the other defendants, not because Sani-Safe or its agent committed any wrong towards Ford. *Id.* at 813; *see also Rogerson*, 96 Wn. App. at 931 (no fees because no real third party involved when party was representative for party to the lawsuit).

Again, the causal connection between the wrongful conduct and the involvement of “B” in separate litigation with an unrelated party requires a showing of “an exceptionally close causal nexus” that is “greater than in an ordinary tort action” to support an award of fees. *See Woodley*, 79 Wn. App. at 247-48. There is no such finding by the trial court’s Judgment or Order on Fees. CP 469-70, 471-73. Further, the second element of the ABC Rule could not have been met by WBC even if it had attempted to because the primary reason WBC was involved in the underlying lawsuit was because Lumpkin and Lumpkin, Inc. chose to sue it in the initial lawsuit, and not just Dykes. In light of the above, the second element of the ABC Rule was not met by WBC, and the reimbursement of fees was reversible error.

4. Lumpkin and Lumpkin, Inc. were not “strangers” to Dykes’ conduct

WBC also failed to make the requisite showing for the third element of the ABC test. Washington courts require that C must be a “stranger” to the event involving A and B in order to recover consequential damages from A. *See Manning*, 13 Wn. App. at 769-70, 773 (listing multiple cases supporting principle and ruling also that principle applies in tort as well as contract); *see also Rogerson*, 96 Wn. App. at 930-31 (no fees under ABC because B was never exposed to liability from a third party C); *Stevens v. Security Pacific Mortgage Co.*, 53 Wn. App. 507, 524, 768 P.2d 1007 (1989) (no fees when B was not “merely a conduit” for A’s wrongdoing) (citation omitted); *Barnett v. Buchan Baking Co.*, 108 Wn.2d 405, 408-09, 738 P.2d 1056 (1987) (no fees when parties in subsequent litigation were also parties to original transaction).

Under this exception to the general non-recoverability of attorney fees outside of contract or statute, “[t]he original suit generating the expenses **must be instituted by a third party not connected with the original transaction.**” *Manning*, 13 Wn. App. at 769 (citing *Armstrong*, 64 Wn.2d at 195) (emphasis added). *See also Haner*, 97 Wn.2d at 757-58; *Brotten v. May*, 49 Wn. App. 564, 572-573, 744 P.2d 1085 (1987) (third

element met because any wrongful acts of C were “wholly independent” of A’s wrongful acts towards B).

In the immediate case, there cannot be a straight-faced argument that Lumpkin and Lumpkin, Inc. were “strangers” to the supposed wrongdoing by Dykes, or that those parties should be considered third parties “wholly independent” from that wrongdoing. Lumpkin and Lumpkin, Inc. were the original plaintiffs in the breach-of-contract action against WBC and Dykes, *see* CP 318, Lumpkin was a general partner of WBC at the time of the supposed wrongdoing by Dykes, *see* CP 19, and Lumpkin, Inc. was adjudicated to have a binding contract with WBC, *see* CP 26. The original conduct that eventually brought about all the litigation, according to the trial court, was the supposed half-hearted attempts by Dykes to have Lumpkin and Lumpkin, Inc. superficially involved in the bidding process. CP 23-25. Superficial or not, there can be no disputing that Lumpkin and Lumpkin, Inc. were not only not strangers to the actions of Dykes, but were active players.

Specifically, Lumpkin, Inc. submitted an estimate to Dykes and WBC for the completion of Buildings 3 and 4 on October 15, 2003. CP 21. According to the underlying trial court’s findings, it was agreed between the parties in the spring of 2004 that Lumpkin Inc.’s proposal could be updated and would be considered by Dykes; however, its offer

had increased over \$100,000. CP 22-23. Moreover, Mr. Travers met with representatives with Lumpkin, Inc. in July of 2004, and based upon that meeting, concluded that MRJ's bid was lower than that of Lumpkin, Inc.'s because Lumpkin's costs included labor and a 10% general contractor's fee. CP 24.

Therefore, regardless of the settled issues of whether Dykes breached a contract with Lumpkin, Inc., or a fiduciary duty to Lumpkin, or whether Dykes was partially motivated by personal animus in not accepting Lumpkin, Inc.'s bid, or whether Dykes's choices were for the objective benefit of the Partnership, etc., there can be no question that Lumpkin and Lumpkin, Inc. were not "strangers" to the transaction that gave rise to the underlying suit. Lumpkin, in particular, as a General Partner to WBC at the time of the supposed wrongdoing by Dykes, was literally a beneficiary of and a party to the construction contract between WBC and MRJ that gave rise to the original suit in the first place. *See Barnett*, 108 Wn.2d at 409 (party not entitled to fees when all litigants "were parties to the original transaction"); *Armstrong*, 64 Wn.2d at 196 (third element not met because both builder and architect were "were privity to the contract", thus no real third party existed).

Whether or not Lumpkin or Lumpkin, Inc. were responsible for, encouraged, discouraged, or otherwise had direct or indirect participation

in Dykes's actions, or knowledge of those actions, are not the legal questions. To meet the third element of the ABC Rule, Lumpkin and Lumpkin, Inc. must be **total strangers** to the original wrongdoing or omission by Dykes. *See Manning*, 13 Wn. App. at 769. This simply cannot be shown when Lumpkin and Lumpkin, Inc. directly sued Dykes and WBC for the breaches alleged against him and his company, and garnered a judgment against Dykes and WBC. This fact differentiates this matter from every case where attorney fees were awarded to a party based on the ABC rule. *See e.g., Brock*, Wn. App. at 571 (third element met when A's wrongdoing "pre-dated" any involvement of C); *Brotten*, 49 Wn. App. at (C was real estate agent that had nothing to do with the A's wrongful assurances to B that he "would be taken care of" in real estate transaction); *Aldrich*, 31 Wn. App. at 20 (contractor C totally unrelated to the transaction where insurance settlement company A fails to investigate credentials of other contractor).

For the ABC rule to apply, there cannot be a direct wrongdoing from A to C, but only A to B, and that which exposes B in litigation from C. *See Haner*, 97 Wn.2d at 758 (trial court erred in finding ABC Rule met because for C to prevail, "the action must have been brought against it by [B]. This did not occur.") C, in other words, cannot have any connection to the wrongdoing by A to B, let alone be the direct adversarial litigant

against A for the same acts that supposedly wronged B.

Again, the trial court in the breach-of-contract matter made no findings or conclusions that that Lumpkin and Lumpkin, Inc. were “strangers” to the transactions to which they were directly involved, nor did the trial court in the immediate case make any such findings or conclusions either. *See* CP 469, 471-73, 474-76.

Therefore, because the third element of the ABC Rule, as well as the first two, was not met by WBC, and the record could not support a conclusion that the element was met, the reimbursement of attorney fees and costs to WBC for the underlying case was reversible error.

B. The award to WBC for attorney fees incurred in the indemnity matter was also without basis in law or equity.

Apart from the reimbursement to WBC for the fees incurred by Dykes and WBC in the breach-of-contract matter, the trial court also awarded WBC fees for bringing the reimbursement suit against Dykes. CP 470. Specifically, the later Order on Fees issued by the trial court awarded WBC \$25,821.50 in attorney fees. CP 461.

The standard of review for whether there was a basis for an award of attorney fees is *de novo* because it is a question of law. *See Deep Water Brewing*, 152 Wn. App. at 277.

1. The “American rule” precludes awarding attorney fees to a prevailing party in absence of a statutory, contractual, or equitable basis.

First, as noted above, Washington follows the “American Rule” in regards to the availability of attorney fees and costs in bringing a cause of action. *See McCready*, 131 Wn.2d at 274-75. “In absence of contract, statute or recognized ground of equity, **a court has no power to award an attorney fee as part of the costs of litigation.**” *Armstrong Const. Co.*, 64 Wn.2d at 195 (citation and internal quotations omitted) (emphasis added); *see also McCready*, 131 Wn.2d at 273-74; *McGreevy v. Oregon Mut. Ins. Co.*, 128 Wn.2d 26, 35 n.8, 904 P.2d 731 (1995) (citations omitted); *Dayton v. Farmers Ins. Co.*, 124 Wn.2d 277, 280, 876 P.2d 896 (1994) (citations omitted); *Rorvig v. Douglas*, 123 Wn.2d at 861 (citations omitted).

Additionally, case law is unambiguous that although fees and costs incurred in the underlying action may be recovered under theory of equitable indemnity, the fees and costs incurred in the indemnity action itself are not. *See Brock*, 50 Wn. App. at 572 (“[F]ees are not recoverable in separate indemnity actions by the innocent defendant against the wrongdoer.”) (citing *Brotten*, 49 Wn. App. at 573). This rule is dispositive.

Also, there is no contractual provision or statute in this matter that could have entitled WBC to its attorney fees in bringing this action. The

statute cited by WBC in its Motion For Summary Judgment, RCW 25.05.170, apart from being utilized almost uniformly in the context of accounting causes of action between partners, provides no basis for indemnity from a partner to a partnership. *See* CP 53.

Moreover, in its Motion, WBC could not cite a provision within the Partnership Agreement that could provide a mechanism for seeking indemnity against a general partner. Instead, the Partnership Agreement provides indemnity from the Partnership to any actions **against** a general partner. *See* CP 74-75. Therefore, the only basis for an award of attorney fees to WBC in this action was in equity, if at all.

Understanding this, WBC sought fees and costs under case law allowing recovery of fees for breaches of fiduciary duties under a court's "inherent powers" (addressed below). However, even assuming Dykes breached a fiduciary duty to WBC — which he did not — this equitable power does not entitle the aggrieved party an award of attorney fees or costs. Despite the assertions by WBC, under Washington law, "[a] fiduciary's breach does not mandate an award of fees." *Green v. McAllister*, 103 Wn. App. 452, 14 P.3d 795 (2000); *see also Perez v. Pappas*, 98 Wn.2d 835, 845, 813 P.2d 475 (1983) (no award of fees despite attorney breach of fiduciary duty); *Shoemaker*, 143 Wn. App. 819, 831, 182 P.3d 992 (2008); *Kelly v. Foster*, 62 Wn. App. 150, 154, 813

P.2d 598 (1991).

Again, the trial court's Order on Fees provides no findings or conclusions as to why it deviated from the long-established rule prohibiting an award of attorney fees to the prevailing party. *See* CP 461.

2. Case law cited by WBC as justification for award of fees under court's "inherent authority" has been severely limited by later case law, and does not apply here even if still good law.

Second, since the only basis on which the trial court could have awarded attorney fees was equitable principles — the only theory posited by WBC — analysis of the relevant case law demonstrates there was no basis for the award.

As a threshold matter, WBC did not even plead that any of the four recognized equitable grounds for attorney fees apply in its complaint or in its Motion For Summary Judgment. *See Pub. Util. Dist. No. 1*, 86 Wn.2d at 390-91 ((1) bad faith; (2) preservation of a common fund; (3) to protect constitutional integrity; and for (4) private attorney general actions). Instead, WBC relied on the rule established in *Hsu Ying Li v. Tang*, 87 Wn.2d 796, 557 P.2d 342 (1976) that attorney fees **may** be assessed to a prevailing party under a court's inherent authority when a fiduciary breach is demonstrated by that party. *See* CP 12 (complaint); CP 58 (WBC MSJ).

To the extent the trial court relied upon the "breach of fiduciary

duty” equitable ground for fees in *Tang*, it was in error. In *Tang*, Hsu Ying Li established a partnership with Gordon Tang to manage an apartment house. 87 Wn.2d at 797. Mr. Tang assumed sole responsibility for the management of the apartment house after five years. *Id.* After about three years, Ms. Li brought an action against Mr. Tang for an accounting. The trial court concluded that Mr. Tang failed to keep adequate books of the partnership, failed to give proper accountings, and commingled his funds with the funds of the partnership. *Id.* The trial court awarded Ms. Li one-half of her attorney fees and expenses. *Id.* Mr. Tang appealed the award of fees, arguing the court did not have authority for the award. *Id.*

The *Tang* Court analyzed the case under the “bad faith” and “common fund” equitable grounds for an award of attorney fees in equity, rejecting both theories. *Id.* at 798-99. The Court, however, believed that the circumstances of that case warranted it to exercise its “inherent power” to award attorney fees to Ms. Li because Mr. Tang breached his fiduciary duty to his partner, and that that breach constituted “constructive fraud,” forcing his partner to bring suit to compel him to satisfy his fiduciary duty. *Id.* at 800.

WBC’s reliance on *Tang* should have been unavailing before the trial court. First, and most obvious, even if still good law, *Tang*

authorized an award of only one-half of the prevailing party's fees. *Id.* at 797. Here, the trial court, without even determining whether the fees in the breach-of-contract action were reasonably incurred by Dykes and WBC, imposed the fees in reimbursement and added those fees to the principal debt now owed by Dykes.

Second, the rule from *Tang* relied upon by WBC has been repeatedly limited and minimized by later case law. Three years after deciding *Tang*, the Washington Supreme Court clarified the scope of its rule in *ASARCO*, 92 Wn.2d at 715-16. The Court in *ASARCO* rejected the appellant's multiple theories for attorney fees, including claims based on equity and inherent "supervisory" power. *Id.* The Court rejected the argument that the Respondents' conduct constituted bad faith or "wanton," but also clarified the relevance of the "constructive fraud" finding in *Tang*: "Hsu's award of attorneys fees [in *Tang*] **was only superficially based on proof of constructive fraud.** The actual award stemmed from the prevailing party having preserved partnership assets, *i.e.*, an identifiable fund." *Id.* at 716 (emphasis added).

This limitation on the rule in *Tang* has been subsequently recognized in multiple appellate cases. *See, e.g., Perez*, 98 Wn.2d at 845 (rejecting appellant reliance on *Tang* for fees in breach of fiduciary duty matter because *Tang* was really about the presence of an "identifiable

fund”) (quoting *ASARCO*, 92 Wn.2d at 716); *Shoemake*, 143 Wn. App. at 831 (“But the Shoemakes misread *Hsu Ying Li*. In fact, the court in *Hsu Ying Li* applied a well-established equitable basis for the award of attorney fees: the prosecution of a successful action to preserve a common fund.”); *Brougham*, 34 Wn. App. 68 (no fees awarded under *Tang*, which is only applicable under “common benefit/common fund” equitable theory).⁵

Third, besides the fact that this matter is not a “common fund” case, the rule that WBC seeks to use from *Tang*, that a trial court may award attorney fees for the breach of fiduciary duty, even if still good law, cannot apply here for the simple fact that Dykes did not breach a fiduciary duty to WBC. See § V.A.2., *supra*. Moreover, even if Dykes did breach a fiduciary duty to WBC, which he did not, WBC did not demonstrate this in either action, nor did either court conclude that such a breach occurred. Nor did WBC bring its action against Dykes to force Dykes to comply with his fiduciary duties; instead, the action was seeking reimbursement for the judgment WBC paid for Dykes’s breach of contract.

Therefore, Washington does not require an award of fees for fiduciary breaches, does not allow for the recovery of fees in separate indemnity actions against the wrongdoer within the context of the ABC

⁵ Cf. *Sandler v. U.S. Dev. Co.*, 44 Wn. App. 98, 107-08, 712 P.2d 532 (1986) (distinguishing *Tang* from that case because no fiduciary breach).

Rule, and later cases have limited application of *Tang* to only common-fund cases. And even if still valid law in allowing for attorney fee awards for breaches of fiduciary duties, neither trial court concluded that Dykes breached any fiduciary duty to WBC. Any award of attorney fees under *Tang* by the trial court was thus without basis in equity or under its “inherent authority”. See *Guntle v. Barnett*, 73 Wn. App. 825, 836, 871 P.2d 627 (1994) (“*Tang* does not command that fees be awarded.”)

3. The award of fees to WBC for the indemnification matter is better characterized as a punitive damage award, which is prohibited by Washington law

Because the trial court had no legal or equitable basis to award attorney fees to WBC in the indemnification matter, the only conclusion to be made is that the award was based on an impermissible expansion of the court’s inherent powers by punishing “bad faith” litigation — an expansion explicitly rejected by this Court.

The Washington Supreme Court has recognized that normally the American Rule addresses circumstances in which attorney fees are considered costs, as opposed to damages. However, within the context of several recognized equitable bases for awarding attorney fees, including when the wrongful act of a third party subjects another party to litigation, such an award constitutes an award of fees *as damages*. See *McCready*,

131 Wn.2d at 275 (citing *Wells*, 60 Wn.2d at 882); see also *Jacob's Meadow Owners Ass'n v. Plateau 44 II LLC*, 139 Wn. App. 743, 759-760, 162 P.3d 1153 (2007) (recognizing same principle).

This is relevant because Washington law does not allow the imposition of punitive damages. This court in *Dempere v. Nelson*, 76 Wn. App. 403, 886 P.2d 219 (1994), *overruled on other grounds by Burnet v. Spokane Ambulance*, 131 Wn.2d 484, 933 P.3d 1036 (2006), specifically noted that there is no authority for a court to impose attorney fees on a party in equity on the basis of “bad faith” for the same conduct that caused the party to be involved in the litigation in the first place. *Dempere*, 76 Wn. App. at 409. This court in *Dempere* continued, noting that states that allow for punitive damages also allow for attorney fees to be part of those damages when a court determines that the underlying conduct was “willful,” “wanton,” or with “malice.” *Id.* Because Washington does not allow for punitive damages, basing an award of attorney fees on equitable grounds for the same “bad faith” as the intentional tort is an impermissible basis for such an award. *Id.*; see also *Shoemake*, 143 Wn. App. at 831-32 (reversing award of fees because trial court treated the award as a sanction for bad faith).

Here, in the absence of a contractual, statutory, or recognized equitable ground justifying the imposition of attorney fees, penalizing

Dykes again by imposing fees here is directly akin to penalizing him for the same bad acts that caused the original suit, which is contrary to this court's holding in *Dempere*. Again, even if the rule regarding imposing fees as damages in for a breach of fiduciary duty from *Tang* is still valid, the trial court did not conclude that there was breach of such a duty to WBC. CP 469-70 (Order Granting MSJ only for indemnity action). Additionally, there was no evidence of bad faith litigation by Dykes in the immediate matter, or even in the underlying matter. Therefore, any imposition of attorney fees reached beyond the trial court's inherent powers and was contrary to Washington law because it is better characterized as a punitive damage award. The award of fees to WBC for the indemnity action was therefore in error, and must be reversed.

C. This court should award Dykes his attorney fees and costs on appeal.

If this court deems Dykes the prevailing party in this appeal, then Dykes respectfully requests that this court award attorney fees under RCW 4.84.080 and RAP 18.1. If the court determines that Dykes is the substantially prevailing party, he also respectfully seeks an award of costs under RAP 14.2 and RAP 14.3.

VI. CONCLUSION

This court must reverse the erroneous reimbursement of attorney fees to WBC from Dykes. Under the American Rule, there must be a

basis in contract, statute, or equity for a court to award attorney fees to the prevailing party. Here, there was no basis in contract or statute, and the court instead imposed the fees against Dykes under the principle of equitable indemnity. To make a valid claim for fees under the equitable indemnity exception to the American Rule, WBC was required to make three specific showings, none of which it even attempted to show, none of which are supported by the evidence, and none of which were found to exist by either trial court. The trial court in the indemnification action also erred in awarding WBC its attorney fees in bringing that suit. There was no basis in contract, statute, or equity for such an award, and the lone authority for the award cited by WBC is wholly inapplicable and cannot justify the award.

Both of these awards were therefore in error, and must be reversed by this court.

Respectfully submitted this 15 day of February, 2011.

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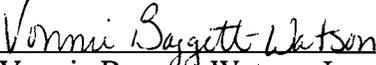
DECLARATION OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on February 15, 2011, I caused service of the foregoing pleading on each and every attorney of record herein:

VIA LEGAL MESSENGER

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Dated this 15th day of February, 2011 at Seattle, Washington.



Vonnice Baggett-Watson, Legal Assistant