

No. 36764-5-II

COURT OF APPEALS, DIVISION II
STATE OF WASHINGTON

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DIVISION II
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STATE OF WASHINGTON
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Fidelity and Deposit Company of Maryland

Appellant

v.

Deborah Jo Dally, a single woman; Navy Federal Credit Union, a Virginia
corporation

Defendants

Allianceone Receivables Management, Inc., a Delaware corporation, dba
Allied Credit and/or Allianceone, Inc.

Respondents

APPELLANT'S BRIEF

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ASSIGNMENTS OF ERROR

1. The trial court erred in entering the Order Granting Motion for Summary Judgment, filed on July 20, 2007, dismissing all of plaintiff/appellant Fidelity's claims against defendant/respondent AllianceOne.

2. The trial court erred in entering the Order Denying Motion For Reconsideration, filed on July 30, 2007.

3. The trial court erred in entering the Order Granting Entry of Final Judgment in Favor of AllianceOne Receivables filed on August 24, 2007 and the Judgment filed therewith.

ISSUES PERTAINING TO ALL ASSIGNMENTS OF RROR

1. Is an indemnity provision of a contact that clearly states that it covers "any loss" "of whatsoever kind of nature," "arising wholly or partially out of an act" taken by the indemnitor, limited only to losses caused by the indemnitor's negligence?

2. Does such an indemnity provision cover losses due to theft of checks sent by the indemnitor to the indemnitee pursuant to the contract?

3. Where a contract requires payment of sums to the “client” designated in the contract, is such an obligation fulfilled by mailing checks that do not name the client as payee?

4. Does a city, as a matter of law, waive any contractual rights, by stamping “for deposit only” and depositing to its account checks received with incorrect payee designations?

5. When a party to a contract makes payments due under the contract by checks that name four non-existent entities, rather than the other party as payee, has that party breached its duty of due care in fulfilling its obligations under the contract?

6. Where a city ordinance provides that only four specified officials are authorized to sign checks on behalf of the city, could a jury reasonably infer that a bank would only cash checks naming the city as payee that were endorsed by one of those designated officials?

7. Where one party to a contract agrees to “defend and save harmless” the other party from “any loss” and that party chooses to make payments under the contract by personal check, could a reasonable jury find that that party breached a duty owed under the contract when it failed to verify whether the checks it sent were received and endorsed by the other party?

8. Did the trial court err in not considering the evidence presented and all inferences therefrom in the light most favorable to the non-moving party, in granting summary judgment?

I. STATEMENT OF THE CASE

In this appeal, plaintiff/appellant Fidelity and Deposit Company of Maryland (Fidelity), as assignee of the City of Poulsbo, seeks reversal of an order granting summary judgment, dismissing all claims against defendant/respondent AllianceOne Receivables Management, Inc (AllianceOne). Fidelity, on behalf of the City of Poulsbo, has asserted claims against AllianceOne for indemnification, breach of contract and negligence. (CP at 1197-89).

This litigation arises out of the theft of checks sent to the City of Poulsbo by respondent AllianceOne pursuant to a Professional Services Contract for collection services. (CP at 24-26). AllianceOne drafted this contract, under which it agreed to collect unpaid fines and other amounts owing to the City of Poulsbo and to pay two-thirds of the funds so collected to the City. As part of the consideration for its fee of one-third of the funds collected, AllianceOne included a broad indemnification provision, by which it agreed to indemnify the City for any loss arising out of its collection activities under this contract. The only exception was for

losses caused by the City's own negligence. The indemnity provision states (with emphasis added):

VIII. INDEMNIFICATION: The Agency agrees and covenants to indemnify, defend and save harmless the client and its officers, agents and employees against and from **any loss**, damage, costs, charges, expense, liability, claims, demands or judgments, **of whatsoever kind of nature**, whether to persons or property **arising wholly or partially out of** an act or omission on the part of the Agency, its subcontractors and/or employees, **except only** such injury or damage as shall have been caused by or resulted from the negligence of the Client.

Under this provision, AllianceOne is liable to indemnify the City for any loss it suffers due to the theft of the collection checks sent to it pursuant to the contract, except to the extent the loss is found to have been caused by the City's negligence.

The Professional Services Contract also requires AllianceOne to make monthly payments to the City, but does not specify how those payments should be made. AllianceOne chose to make the payments by personal checks drawn on its business account. Although it is undisputed that the City of Poulsbo is the "client" referred to in the contract (CP at 22), which was signed by the then Mayor of Poulsbo on behalf of the City (CP at 26), AllianceOne did not name the City as payee on its payment checks. It is undisputed that none of the stolen checks were made out to the City of Poulsbo. Instead, the checks contained one of the following payee names: "Poulsbo Municipal Court," "Poulsbo Municipal

Infractions,” “Poulsbo Municipal,” or “Poulsbo Municipal Criminal.” (CP at 22). None of these named payees is an existing legal entity.

The Poulsbo Municipal Code, Section 3.04.030, provides that only the mayor, deputy mayor, alternate deputy mayor and the finance director are authorized to sign checks on behalf of the City. Absent indorsement by one of these officials, checks payable to the City can only be deposited into a City account. The City of Poulsbo’s bank, North Sound Bank, has been willing to deposit the checks from AllianceOne, stamped with the City’s “For Deposit Only” stamp, to the City’s account despite the errors in the payee designations on those checks. (CP at 153-55). However, the use of these non-existent payee names by AllianceOne was in violation of its contract, which required payment be made to the City. The City sustained a loss when it did not receive the payments made by the stolen checks. The use of the non-existent payees on the checks contributed to the City’s loss by making it easier for the thief to negotiate the stolen checks.

The City suffered a substantial loss when numerous checks sent by AllianceOne to the City of Poulsbo were not deposited to the City’s account, but were stolen by defendant Dally, who at the time worked for the City as a municipal court administrator. Dally intermittently stole checks and changed accounting records to cover-up her theft. (CP at

1025, 1182). She signed the checks in the name of the non-existent payee, followed by the forged signature of a former court administrator, who was never authorized to sign checks on behalf of the City. Tellers at defendant Navy Federal Credit Union (NFCU) cashed the forged checks and deposited the funds into the personal account of defendant Dally. (CP at 1082-1110).

There is no evidence that the City of Poulsbo was aware that Dally planned to embezzle funds from the City or that negligence by the City caused the initial thefts. Dally's occasional, selective thefts of AllianceOne checks continued for a period of six years until they were discovered. These stolen checks caused the City a loss of collection revenue in the amount of \$306,261. (CP at 1183, 1190). Disputed issues of fact concerning the negligence and liability of defendant NFCU for cashing the forged checks, and any contributing negligence of the City for not discovering the thefts sooner, remain for trial.

Defendant/respondent AllianceOne filed a motion for summary judgment seeking dismissal of Fidelity's claims against it. AllianceOne argued that the indemnity provision only applied to losses proximately caused by the negligence of AllianceOne, despite the clear language of the provision. AllianceOne further argued that it owed no duty under the contract to make its required payments by checks properly made out to the

City of Poulsbo, that the City had somehow waived any right to have payments properly made to it, and that making the checks payable to non-existent payees could not have contributed to the City's loss. (CP at 1-20).

The trial court granted AllianceOne's motion, in an Order filed July 20, 2007. (CP at 1172-74). Plaintiff/appellant Fidelity filed a motion for reconsideration, which the court denied without hearing in an Order entered July 30, 2007. (CP at 1177-78). The court entered a final Judgment dismissing all claims against AllianceOne on August 24, 2007. (CP at 1294-13-1).

The standard of review on appeal is *de novo*. On review of summary judgment, the appeals court engages in the same inquiry as the trial court. *Vallandigham v. Clover Park School Dist. No. 400*, 154 Wn.2d 16, 26, 109 P.3d 805 (2005); *Folsom v. Burger King*, 135 Wn.2d 658, 633, 958 P.2d 301 (1998).

II. ARGUMENT

A. The Trial Court Erred in Ruling that AllianceOne Is Not Liable for the City's Loss Under the Indemnification Clause in Its Professional Services Contract.

In granting summary judgment for AllianceOne, the trial court erroneously held that the Indemnification Clause was limited to losses proximately caused by negligent omissions by AllianceOne. The plain

language of the clause contains no such limitation. AllianceOne agreed in its Professional Services Contract to indemnify the City of Poulsbo for “any loss” it might incur “arising wholly or partially out of” AllianceOne’s acts under the contract. The Indemnification clause states (with emphasis added):

VIII. INDEMNIFICATION: The Agency agrees and covenants to indemnify, defend and save harmless the client and its officers, agents and employees against and from **any loss**, damage, costs, charges, expense, liability, claims, demands or judgments, **of whatsoever kind of nature**, whether to persons or property **arising** wholly or **partially out of an act** or omission on the part of the Agency, its subcontractors and/or employees, **except only** such injury or damage as shall have been caused by or resulted from the negligence of the Client.

(CP at 25-26). Pursuant to this provision, as part of the consideration for its fee of one-third of all amounts collected, AllianceOne undertook responsibility for any risk of loss from its collection activities, assuring the City of receiving the remaining two-thirds of the funds collected. The loss resulting from the theft of payment checks sent by AllianceOne to the City is covered by this provision. The only exception to AllianceOne’s indemnity obligation is for damages caused by the City’s negligence.

Although AllianceOne could have drafted a more narrow indemnification clause limiting liability only to losses caused by its negligence (*see Pruneda v. Otis Elevator Co.*, 65 Wn. App. 481, 488, 828 P.2d 642 (1992) (clause provided indemnity for loss “arising out of the

contractor's negligent acts or omissions”)), it did not do so. A somewhat similar set of facts was presented to the Washington Court of Appeals in *MacLean Townhomes v. America 1st Roofing & Builders, Inc.*, 133 Wn. App. 828, 138 P.3d 155 (2006). In that case, a subcontractor agreed to indemnify the general contractor for “any and all claims.” The subcontractor claimed the provision only applied to tort, and not contract, claims. The Court of Appeals disagreed, stating:

P.J. Interprize ... would have us read the contract as though, in the first sentence above-quoted, the word “tort” was placed between the word “all” and the word “claims.” However, this would dramatically alter the meaning of the phrase “any and all claims.” Although the parties could have drafted the provision in the manner urged by P.J. Interprize, they did not.

133 Wn. App. at 832. *Accord, Jacob's Meadow Owners Assn. v. Plateau 44 II, LLC* (Court of Appeals Nos. 57543-1-I, 57649-6-I, July 23, 2007).

In *McDowell v. Austin Company*, 105 Wn.2d 48, 710 P.2d 192 (1985), the Washington Supreme Court held that an agreement to indemnify against “all liability” was triggered by liability, not negligence, stating:

Parties are free to establish liability instead of negligence as the triggering mechanism of an indemnity contract.

105 Wn.2d at 51. Here, AllianceOne could have drafted the Indemnification clause to apply only to losses arising out of its “negligent” acts or omissions, but it did not. The clause applies to “any loss” arising,

even in small part, from AllianceOne's collection activities under the contract.

Applying the fundamental rules of contract construction, the indemnification clause covers the City's loss, and summary judgment should not have been granted to AllianceOne. As the court explained in *MacLean Townhomes*:

When interpreting an indemnity provision, we apply fundamental rules of contract construction. *Jones v. Strom Constr. Co.*, 84 Wn.2d 518, 520, 527 P.2d 1115 (1974). The words used in a contract should be given their ordinary meaning. *Universal/Land Constr. Co. v. City of Spokane*, 49 Wn. App. 634, 637, 745 P.2d 53 (1987). Courts may not adopt a contract interpretation that renders a term absurd or meaningless. *Seattle-First Nat'l Bank v. Westlake Park Assocs.*, 42 Wn. App. 269, 274, 711 P.2d 361 (1985).

133 Wn. App. at 831. Any ambiguity in an indemnification clause must be resolved against the party who prepared the contract. *Knipschild v. C-J Recreation, Inc.*, 74 Wn. App. 212, 215, 872 P.2d 1102 (1994). When "or" is used in a contract disjunctively to separate terms, this court must read the two terms separately and distinctly. *State v. Bolar*, 129 Wn.2d 361, 365, 917 P.2d 125 (1996). The indemnification clause at issue here covers "any loss" arising out of an "act or omission" by AllianceOne.

Hence, it is not limited to losses due to negligent omissions, as AllianceOne contends. The clause also applies to losses that arise "wholly or partially" out of an act taken under the contract. AllianceOne has

agreed to indemnify the City if the loss arises even in small part from an act by AllianceOne.

The words “arising ... out of” as used in the indemnification clause do not require a finding of proximate cause, but only that the loss grows out of or flows from an act of AllianceOne. In *Toll Bridge Authority, v. Aetna Insurance Co.*, 54 Wn. App. 400, 406, 773 P.2d 906 (1089), the court held that: “‘Arising out of’ and ‘proximate cause’ describe two different concepts.” The court explained:

The phrase "arising out of" is unambiguous and has a broader meaning than "caused by" or "resulted from." *STATE FARM MUT. AUTO. INS. CO. v. CENTENNIAL INS. CO.*, 14 Wn. App. 541, 543, 543 P.2d 645 (1975), REVIEW DENIED, 87 Wn.2d 1003 (1976). It is ordinarily understood to mean "originating from", "having its origin in", "growing out of", or "flowing from". *AVEMCO INS. CO. v. MOCK*, 44 Wn. App. 327, 329, 721 P.2d 34 (1986).

54 Wn. App. at 405. *Accord, Parkridge Assocs., Ltd. v. Ledcor Indus., Inc.*, 113 Wn. App. 592, 603, 54 P.3d 225 (2002). AllianceOne chose to make the payments due under the contract by corporate check, some of those checks were stolen, and the City of Poulsbo suffered a loss because it did not receive funds owed to it under the contract. This loss certainly at least partially arose out an act of AllianceOne.

Further, as the court in *MacLean Townhomes* noted, a court should not “adopt a contract interpretation that renders a term absurd or

meaningless.” 133 Wn. App. at 831. If the indemnification clause were construed to apply only to losses proximately caused by the negligence of AllianceOne, then the exception for losses caused by the negligence of the City would be rendered meaningless, contrary to the fundamental rules of contract construction. If the clause is construed to only apply to damages for liability, as AllianceOne contends in its Reply brief to the trial court (CP at 1162), then most of the terms in the phrase “from any loss, damage, costs, charges, expense, liability, claims, demands or judgments, of whatsoever kind of nature” (emphasis added) are rendered meaningless. Since AllianceOne drafted this contract, any ambiguity the court may find in its terms must be construed against AllianceOne and in favor of the City of Poulsbo. *Knipschild v. C-J Recreation, Inc.*, 74 Wn. App. 212, 215, 872 P.2d 1102 (1994).

As noted above, the only loss excluded from the indemnification clause of the Professional Services Contract was that “caused by or resulted from the negligence of the Client.” Disputed issues of fact remain concerning whether and to what extent the City’s loss may have been caused by its own negligence. The only evidence AllianceOne submitted concerning the City’s negligence at best suggests that the City could have discovered the thefts sooner. AllianceOne submitted no evidence showing that any negligence of the City caused the original thefts, nor does the

evidence submitted show exactly when the thefts should have been discovered earlier than they were. Viewing the submitted evidence and all inferences therefrom in the light most favorable to Fidelity, as assignee of the City of Poulsbo, as is required on a motion for summary judgment, the trial court erred in granting summary judgment for AllianceOne on Fidelity's indemnification claim.

B. The Trial Court Erred in Dismissing Fidelity's Breach of Contract Claim Against AllianceOne.

AllianceOne failed to show that there were no issues of fact and that it was entitled to judgment as a matter of law on Fidelity's breach of contract claims. Under the Professional Service Contract, AllianceOne was required to pay to "the Client" the funds collected under the contract. In the contract, "the Client" was defined as either "City of Poulsbo Municipal Court" or "City of Poulsbo." In its motion, AllianceOne admitted that the municipal court was not a separate entity, but a part of the City of Poulsbo. (CP at 12). In her declaration, Patricia Purcell admitted that AllianceOne's client under this contract was the City of Poulsbo. (CP at 22). Nevertheless, AllianceOne chose to make its required payments to the City by checks, drawn on its business account, that did not designate the "City of Poulsbo" as payee. Rather, it sent

checks made out variously to one of four, non-existent payees: “Poulsbo Municipal Court,” “Poulsbo Municipal Infractions,” “Poulsbo Municipal,” or “Poulsbo Municipal Criminal.” These checks did not meet AllianceOne’s contractual obligation to pay the collected funds to the client, the City of Poulsbo. AllianceOne argued in its Reply brief to the trial court, that it had no obligation to list the “City of Poulsbo” as payee on the checks, because the contract did not specify a payee name. However, the contract clearly states in paragraph VII: “Funds collected by the Agency shall be paid to the Client...,” which is the City of Poulsbo. (CP at 25).

Apparently recognizing its potential liability for breach of contract, AllianceOne argued in its motion that the City of Poulsbo somehow waived its right to payment under the contract by checks properly made payable to it. However, waiver requires the voluntary relinquishment of a known right:

The one against whom waiver is claimed ... must intend to relinquish such right, advantage, or benefit; and his actions must be inconsistent with any other intention than to waive them.

Singer Credit Corp. v. Mercer Island Masonry, Inc., 13 Wn. App. 877, 885, 538 P.2d 544 (1975). AllianceOne presents no evidence that the City has intentionally waived the right to receive payment under the Professional Services Contract by checks properly listing the City as

payee. The case of *Sherman v. Lunsford*, 44 Wn. App. 858, 723 P.2d 1176 (1986), cited by AllianceOne, is inapposite, because there both parties testified that they had entered into an oral agreement to change the terms of the contract. 44 Wn. App. at 861. There is no evidence of any such agreement here. Indeed, the City has never indorsed the checks with the improper payee names. Rather, the City stamps the checks for deposit only for the "City of Poulsbo," the proper payee name. (CP at 1153-55). Should the City's bank refuse to deposit these checks to the City's account, AllianceOne would be required to replace the checks with ones properly naming the "City of Poulsbo" as payee. It is not reasonable to infer that the City has waived its right to be so paid under the contract.

Further, on summary judgment:

Any doubts as to the existence of a genuine issue of material fact are resolved against the moving party. In addition, we consider all the facts submitted and the reasonable inferences therefrom in the light most favorable to the nonmoving party.

Atherton Condominium Apartment-Owners Association Board of

Directors v. Blume Development Co., 115 Wn.2d 506, 516, 799 P.2d 250 (1990).

C. The Trial Court Erred in Dismissing Fidelity's Negligence Claim Against AllianceOne

AllianceOne has failed to show that there is no dispute of fact concerning Fidelity's claims that AllianceOne was negligent in 1) sending payments to the City by checks with improper payee designations and 2) failing to verify indorsements on these checks, and that this negligence contributed to the City's loss.

AllianceOne owed a duty to the City of Poulsbo to perform its obligations under the Professional Services Contract with reasonable care. As AllianceOne notes, the contract did not specify the method of payment for funds owed by AllianceOne to the City. AllianceOne chose to make the payments by personal check, rather than by cash, certified check, electronic funds transfer or some other method. It owed the City a duty to use reasonable care in whatever method of payment it chose. A jury could find that AllianceOne breached its duty of care when it sent payments by checks made payable, not to the "City of Poulsbo" or "City of Poulsbo Municipal Court," but to four other incorrect payee names.

The trier-of-fact could also find that this negligence was a proximate cause of the City's loss. The uncontroverted evidence shows that not a single check properly listing the City of Poulsbo as payee was stolen by defendant Dally. Not a single check properly made payable to

City of Poulsbo was cashed by the defendant credit union, NFCU. The undisputed evidence also shows that the City of Poulsbo did not routinely endorse checks, but stamped them for deposit only to its account. Section 3.04.030 of the Poulsbo Municipal Code clearly specifies which city officials have authority to sign checks on behalf of the city:

Authority to sign checks.

The city of Poulsbo officers authorized or required to sign such checks are the mayor, deputy mayor, alternate deputy mayor and the finance director.

(Ord. 85-14 § 2, 1985; Ord. 74-31 § 3, 1974). AllianceOne presented no evidence that defendant Dally would have stolen, and more critically that defendant NFCU would have cashed, checks properly listing City of Poulsbo as payee. On a motion for summary judgment, all reasonable inferences must be made in favor of the non-moving party, appellant Fidelity. *Atherton Condominium*, 115 Wn.2d at 516. “[R]easonable inferences from the evidence must be resolved against the moving party.” *Folsom v. Burger King*, 135 Wn.2d 658, 633, 958 P.2d 301 (1998).

Absence evidence to the contrary, a reasonable jury could infer that the bank tellers would not have cashed checks properly made payable to the City of Poulsbo that were not signed by an authorized city official, as required by law.

The second basis for Fidelity's negligence claim is that AllianceOne was negligent in failing to verify indorsements on its payment checks. Under the Professional Services Contract, AllianceOne agreed to "defend and save harmless" the City from any loss arising from its collection activities. This provision placed a duty on AllianceOne to take reasonable measures to protect the City from loss and ensure that the City received the funds owing to it under the Contract. A jury could find that, when it chose to make payments due under the Contract by personal corporate check, AllianceOne should reasonably have foreseen the risk that the checks might be lost or stolen. Foreseeability of a risk is a question of fact that should be determined by the trier-of-fact. *Shepard v. Mielke*, 75 Wn. App. 201, 206, 877 P.2d 220 (1994). One way to protect against that risk is to verify indorsements. The Washington State Legislature has placed this duty on all drawers with regard to the liability of the payor bank. RCW §62A.4-406(f) provides that a drawer who "does not within one year ... discover and report any unauthorized indorsement is precluded from asserting against the bank such unauthorized signature or indorsement...." This provision was deleted from the 1991 revisions of the uniform act, but was kept by the Washington legislature when it enacted those revisions in 1993. Even a cursory review of the returned checks would have revealed the thefts, as all checks deposited by the City were

stamped for deposit only, while the checks cashed by defendant Dally all indorsed in handwriting with the name of the non-existent payee, the name of the former administrator, and defendant Dally's name and account number.

Fidelity contends that a jury could reasonably find that AllianceOne breached its duty of care under the contract to "defend and save harmless" the City from any loss, by failing to ever check the indorsements on its checks. This duty of care merely extends the duty AllianceOne already owed the payor bank and arose from AllianceOne's choice to make the payments due under Professional Services Contract by personal check. Had AllianceOne checked indorsements and notified the City of the forgeries, much of the City's loss could have been avoided. Fidelity respectfully submits that the trial court failed to properly view the evidence and all inferences therefrom in the light most favorable to the nonmoving party and erred in dismissing Fidelity's negligence claims.

III. CONCLUSION

Plaintiff/appellant Fidelity and Deposit Company of Maryland (Fidelity), as assignee of the City of Poulsbo, requests that this Court reverse the Order Granting Motion for Summary Judgment filed on July 7, 2007, dismissing all claims against defendant/respondent AllianceOne Receivables Management, Inc., and reverse the Order Denying Motion for

Reconsideration filed July 30,2007, and remand this matter for trial on all claims alleged against respondent/defendant AllianceOne.

Dated this 18 day of January, 2008.

Respectfully submitted,



Alexander Friedrich
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DIVISION II

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STATE OF WASHINGTON

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COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

FIDELITY AND DEPOSIT COMPANY OF)
MARYLAND, as assignee of the)
CITY OF POULSBO,) NO. 36764-5-II

Appellant,)

v.)

DEBORAH JO DALLY, a single) CERTIFICATE OF SERVICE
woman; NAVY FEDERAL CREDIT)
UNION, a Virginia corporation,)
ALLIANCEONE RECEIVABLES)
MANAGEMENT, INC., a Delaware)
corporation, dba ALLIED CREDIT,)
and/or ALLIANCEONE, INC.,)

Respondents.)

CERTIFICATE

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Signed at Seattle, Washington, on January 18, 2008.



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