

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 RESPONSE BRIEF

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I. CLARIFICATION TO STATEMENT OF THE CASE

In its Counter Statement of the Case and elsewhere in its brief, AllianceOne repeatedly states that the City of Poulsbo “negotiated” the checks AllianceOne sent bearing the names of four non-existent entities as payees. AllianceOne is using the term “negotiated” in an incorrect and possibly misleading way. Under the Uniform Commercial Code (UCC), “negotiation” occurs when a check is indorsed, which requires the signature of the payee. *See* RCW 62A.3-201, RCW 62A.3-203, RCW 62A.3-204. The City of Poulsbo did not sign the checks sent by AllianceOne. Rather, the checks were stamped “For Deposit Only – City of Poulsbo” and transferred to the City’s bank for deposit into the City’s accounts. At no time did the City indorse the checks in the names of the non-existent payees.

Throughout its brief, AllianceOne also equates the loss suffered by the City with the theft of the checks. However, the theft in and of itself did not cause the City’s loss. Lost or stolen checks that are not cashed do not cause any financial loss. The loss was incurred when the defendant bank, Navy Federal Credit Union, cashed the checks upon forged indorsements and deposited the funds to defendant Dally’s personal accounts for her personal use. The forged indorsements on the checks were not made in the name of the City of Poulsbo. Rather, the forged

indorsements were in the names of the non-existent entities that AllianceOne named as payees on the checks.

The issue of the defendant bank's liability for cashing the checks upon forged indorsements remains for trial in this matter. Upon reversal of the summary judgment involved in this appeal, the actual amount of AllianceOne's contractual obligation to indemnify the City of Poulsbo will also be determined at trial. That liability admittedly extends only to the City's, and its assignee Fidelity's, out-of-pocket losses that were not caused by the City's own negligence and are not recovered from the other defendants. Similarly, the trier-of-fact will determine the extent to which AllianceOne's negligence contributed to the forgery and conversion of the checks, and whether AllianceOne is liable to the City for breach of contract. A criminal restitution order has already been entered against defendant Dally, but no funds have been recovered.

II. ARGUMENT

A. The Trial Court Erred in Dismissing Fidelity's Claim Under the Indemnification Clause

AllianceOne is liable to indemnify the City for its loss under the very broad indemnification clause it drafted in order to induce the City to agree to the very lucrative Personal Services Contract with AllianceOne. Under this contract, AllianceOne was allowed to add a 50% fee to the

balances owing on the accounts assigned to it by the City, and was allowed to keep one-third of all funds it collected. (CP at 25). In return, AllianceOne agreed to the broad indemnification clause, assuring the City of receiving the funds due to it, with the only exception being for losses caused by the City's own negligence.

1. The Indemnification Clause Covers "Any Loss"

The indemnification clause by its terms applies to "any loss, damage, costs, charges, expense, liability, claims, demands or judgments, of whatsoever kind of nature..." (CP at 25-26). AllianceOne now contends that this clause does not include loss due to criminal acts. However, there is no exclusion for criminal acts, but rather the clause by its clear language applies to losses "of whatsoever kind of nature." By comparison, the insurance contract at issue in the *Stouffer* case, cited by AllianceOne, contained a specific exclusion for losses due to criminal acts.

AllianceOne also argues that use of the words "liability claims, demands or judgments" (misquoting the clause by ignoring the comma between "liability" and "claims") indicates that the provision should be limited indemnification for third-party claims against the City. Such an interpretation would require the court to ignore the terms "any loss, damage, costs, charges, expense..., of whatsoever kind of nature." This would violate fundamental rules of contract construction which require

that courts not adopt an interpretation that renders terms in the contract meaningless. *McLean Townhomes v. America 1st Roofing & Builders, Inc.*, 133 Wn. App. 828, 831, 138 P.3d 155 (2006). Under the indemnification clause drafted by AllianceOne, loss as well as liability triggers the right to indemnification.

2. The Indemnification Clause Is Not Limited to Proximately Caused Losses

The indemnification clause that AllianceOne drafted is not by its terms limited to losses proximately caused by acts of AllianceOne. Rather, it extends to any loss “arising wholly or partially out of” an act by AllianceOne. A connection between an act of AllianceOne pursuant to the contract and the loss is required, but not proximate cause. As explained in Fidelity’s opening brief, “arising out of” is broader than “proximate cause” and only requires that the loss grows out of or flows from an act by AllianceOne. *Toll Bridge Authority, v. Aetna Insurance Co.*, 54 Wn. App. 400, 405, 773 P.2d 906 (1089). The indemnification clause drafted by AllianceOne broadens this concept even further by requiring only that the loss arise “partially” out of an act or omission by AllianceOne.

Fidelity identified at least two acts and one omission by AllianceOne from which all or part of its loss arose. First, AllianceOne chose to make its contractual payments to the City by personal corporate

check, rather than by wire transfer, direct deposit, cashier's check or some other method. The City's loss due to theft and fraudulent conversion of the checks flowed from this act by AllianceOne. Second, AllianceOne chose to name four non-existent entities as payees on the checks it sent, rather than the City of Poulsbo. The City's loss due to theft and conversion of these checks flowed from this act. Only checks naming non-existent entities as payees were stolen and only checks with these payee designations were cashed over forged endorsements by the bank. AllianceOne has presented no evidence that the bank would have cashed checks made properly payable to the City of Poulsbo that were not indorsed by an authorized official of the City. Third, AllianceOne failed to check indorsements on the returned checks after undertaking to "save harmless" the City from "any loss." Some of the City's loss arose from this omission which contributed to the delay in discovering the thefts.

3. The Indemnification Clause Is Not Limited to Wrongful Acts or Omissions by AllianceOne.

The indemnification clause by its terms is not limited to losses due to acts or omissions by AllianceOne that are wrongful, under tort or other legal theory, as AllianceOne asserts at page 28 of its brief. AllianceOne cites no case law or other authority for its assertion that, as a matter of law, parties cannot contract for indemnification of losses arising out of

acts that are not wrongful. Under Washington law, parties to a commercial contract can allocate the risk of loss in any manner not against public policy. A party can even contract for indemnification of losses due to the party's own negligence. *See, e.g., Northwest Airlines v. Hughes Air Corp.*, 104 Wn.2d 152, 154, 702 P.2d 1192 (1985).

4. Alliance Did Not Submit Evidence Proving That The City's Loss Was Entirely Caused By It's Own Negligence

The evidence submitted to the trial court by AllianceOne did not prove, as a matter of law, that the City's loss was entirely caused by its own negligence, so as to exempt Alliance from all liability under the indemnification clause, as AllianceOne asserts on page 31 of its brief. This argument was not raised to the trial court, and the trial court did not so find. There is no evidence that the City of Poulsbo was aware that Dally planned to embezzle funds from the City or that any negligence by the City caused the initial thefts. The audit report submitted by AllianceOne notes that defendant Dally "circumvented the Court's internal controls." (CP at 1038). At best, AllianceOne's evidence suggests that the City should have discovered the thefts sooner. It is for the trier-of-fact to decide the extent to which the City's loss was caused by its own negligence, by the negligence of the defendant bank, or by the negligence

of AllianceOne. AllianceOne is contractually obligated to indemnify the City for any loss that was not caused by the City's negligence.

B. The Trial Court Erred In Dismissing Fidelity's Claim for Breach of Contract.

The trial court erred in dismissing Fidelity's claims that AllianceOne breached its contract with the City of Poulsbo by making its required payments with checks made payable to four non-existent entities. While the contract does not specify how payments were to be made, it clearly specifies that funds collected were to be paid to the "Client" under the contract. The client was identified as the City of Poulsbo or City of Poulsbo Municipal Court. AllianceOne has admitted that the municipal court is not a separate entity but part of the City of Poulsbo, and that the City was its client. Adding the words "Municipal Court" to the payee line after "City of Poulsbo" would be merely descriptive and would not change the payee designation. The checks sent by AllianceOne were not made payable to either the City of Poulsbo or City of Poulsbo Municipal Court. Rather, they were made payable to four non-existent entities. Sending checks made payable to entities other than the designated "client" (City of Poulsbo or City of Poulsbo Municipal Court) did not fulfill AllianceOne's payment obligation under the contract. The City has suffered a loss due to

this breach of contract to the extent it did not actually receive funds due under the Professional Services Contract.

AllianceOne argues that it is not liable for breach of contract, even though it did not pay the City as required under the contract, because making the checks payable to the City of Poulsbo would not have prevented Dally's theft. This argument is without merit for several reasons. First, AllianceOne had contractual obligation to pay funds collected to the city, which it did not do. Checks made payable to non-existent entities did not fulfill its contractual obligation. Second, the uncontroverted evidence that Dally did not steal any checks properly made payable to the City of Poulsbo supports the inference that she would not have stolen such checks. Third, the fact that the defendant bank did not cash and deposit to Dally's account any checks made payable to the City of Poulsbo, and the requirements established by city ordinance for signing checks on behalf of the city, support the inference that the bank would not have cashed checks that designated the City of Poulsbo as payee. As noted earlier, it is the conversion of the checks by the bank, not the theft by Dally alone, that resulted in the loss to the City. On a summary judgment motion, all inferences are to be made in favor of the non-moving party, Fidelity. *Atherton Condominium Apartment-Owners Association*

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

There is no evidence that the City of Poulsbo had waived its contractual right to receive payment under the contract. Waiver by the City cannot be based on AllianceOne's unilateral acts of naming nonexistent entities as the payees on its checks. Stamping the checks "For Deposit Only-City of Poulsbo" does not meet the requirements of showing an intentional and voluntary relinquishment of the City's right to be properly named as payee on payment checks sent pursuant to the contract. AllianceOne has cited no case authority so holding. An inference of waiver cannot support summary judgment, because all inferences are to be made in favor of the non-moving party, Fidelity.

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

The trial court erred in dismissing Fidelity's negligence claims, because evidence was submitted showing that AllianceOne had breached its duty to exercise due care in carrying out its obligations under the Personal Services Contract. AllianceOne did not act with due care when it named four non-existent payees on checks for payments owed under the contract. It also breached the duty of care it undertook when it agreed to "defend and save harmless" the City from "any loss" arising from its collection activities, by failing to verify indorsements on its returned

checks. The *Stouffer* case cited by AllianceOne is inapposite. The insurance contract involved in that case did not provide for loss control services, while here AllianceOne specifically agreed, in a contract it drafted, to “defend and save harmless” the City from “any loss.”

Fidelity respectfully contends that the trial court erred in ruling that a reasonable trier-of-fact could not conclude that AllianceOne’s negligent acts contributed to the City’s loss. Fidelity contends that a trier-of-fact could infer from the uncontroverted fact that Dally did not steal any checks naming the City of Poulsbo as payee, that she would not have stolen checks properly naming the City as payee. Further, a trier-of-fact could infer from the uncontroverted facts that 1) the bank did not cash any checks made payable to the City of Poulsbo, 2) the City routinely stamped checks it received “For Deposit Only,” 3) the municipal code designates that only four specific City officials have authority to sign checks on behalf of the City, and 4) none of the converted checks was signed in the name of these specified city officials, that the bank would not have cashed and deposited to Dally’s account checks properly made payable to the City of Poulsbo. The trial court erred in not making these reasonable inferences in favor of the non-moving party, Fidelity.

Fidelity would like to point out that, on page 20 of its brief, AllianceOne misquotes RCW 62A.3-405, which concerns the liability of

an employer for checks fraudulently indorsed by an employee. That provision defines “fraudulent indorsement” as “a forged indorsement purporting to be that of the employer.” RCW 62A.3-405(a)(2). A fraudulent indorsement by a trusted employee is “effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person.” RCW 62A.3-405(b). This provision would apply here only if the checks were made payable to the City of Poulsbo and Dally fraudulently indorsed them in the name of someone authorized to sign checks for the City of Poulsbo. Here, AllianceOne negligently did not make the checks payable to the City, but to four non-existent entities. This court should reverse the granting of summary judgment and allow the trier-of-fact to determine the extent the negligence of each party contributed to the City’s loss.

III. CONCLUSION

AllianceOne failed to meet its burden, on moving for summary judgment, to show that there were no issues of material fact and that it was entitled to judgment on any of Fidelity’s claims. 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 25th day of April, 2008.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Alexander Friedrich', written over a horizontal line.

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STATE OF WASHINGTON COURT OF APPEALS
DIVISION II

FIDELITY AND DEPOSIT COMPANY OF)
MARYLAND, as assignee of the)
CITY OF POULSBO,) APPEAL NO. 36764-5-II
Plaintiff,)
v.)
DEBORAH JO DALLY, et al,) CERTIFICATE OF SERVICE
Defendants.)

CERTIFICATE

A. I, ALEXANDER FRIEDRICH, certify that on April 25, 2008, as set forth below I sent by regular United States Mail, postage prepaid, a copy of Appellant's Response Brief:

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