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**SUPREME COURT
OF THE STATE OF WASHINGTON**

AFFILIATED FM INSURANCE COMPANY,
a Rhode Island corporation,

Plaintiff-Appellant,

v.

LTK CONSULTING SERVICES, INC.,
a Pennsylvania corporation,

Defendant-Appellee.

*On Certified Question from the
United States Court of Appeals for the Ninth Circuit
Case No. 07-35696*

**RESPONSE BRIEF OF
LTK CONSULTING SERVICES, INC.**

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ASSIGNMENTS OF ERROR

This matter comes before the Court on the following question certified by the United States Court of Appeals for the Ninth Circuit in *Affiliated FM Insurance Co., v. LTK Consulting Servs., Inc.*, 556 F.3d 920, 921 (9th Cir. 2009):

May party A (here, SMS, whose rights are asserted in subrogation by AFM), who has a contractual right to operate commercially and extensively on property owned by non-party B (here, the City of Seattle), sue party C (here, LTK) in tort for the damage to that property, when A (SMS) and C (LTK) are not in privity of contract?

The certified question raises two issues:

1. Does the economic loss rule bar SMS' tort claim for property damage, where SMS commercially operates, but does not own, the damaged property?
2. Does the economic loss rule bar SMS' tort action against LTK, where LTK and SMS were not in privity of contract for the services that were the alleged cause of SMS' loss?

STATEMENT OF THE CASE

The material facts have been summarized by the Ninth Circuit in its order certifying the question.

In the underlying federal lawsuit, plaintiff Affiliated FM Insurance Co. (“AFM”), as subrogee of Seattle Monorail Systems Joint Venture (“SMS”), sued defendant LTK Consulting Services, Inc. (“LTK”). *Affiliated FM Ins. Co. v. LTK Consulting Servs., Inc.* [“*Affiliated FM II*”], 556 F.3d 920, 920 (9th Cir. 2009).

The Seattle Monorail is owned by the City of Seattle (the “City”). In 1994, the City entered into a Monorail Concession Agreement (the “Concession Agreement”) with SMS. The Concession Agreement provided that SMS would operate the Monorail, but the City “retained the right to enter the property and to adjust operation of the Monorail System as necessary.” *Id.* Specifically, the City retained the right, but not the obligation, to make repairs, improvements, alterations, and additions to the Monorail system throughout the Concession Agreement’s term. E.R. 095.¹

The Concession Agreement further provided that SMS was required to maintain insurance on the Monorail system, with the policy

¹ “E.R.” refers to the two-volume Excerpt of Record before the Ninth Circuit, which has been transmitted to this Court.

naming the City as the loss payee. SMS purchased the insurance from AFM. *Affiliated FM II*, 556 F.3d at 920. Apart from the insurance, SMS was required to pay the costs of all ongoing maintenance and repairs, up to an annual “maintenance expenses cap” amount. E.R. 027, 053-054.

In 1999, the City contracted with LTK for consulting services to examine the Monorail system and recommend repairs. SMS was not a party to that contract. *Affiliated FM II*, 556 F.3d at 920. The parties dispute the extent of LTK’s work. LTK asserts that it did not recommend any changes to the Monorail’s electrical grounding system and that none were made. LTK also asserts that the pre-existing grounding system was the safest and most appropriate system for the Monorail. AFM asserts that LTK recommended certain changes to the grounding system and that those changes were made. For purposes of answering the certified question, this Court need not resolve that issue.

On May 31, 2004, one of the Monorail trains caught fire. AFM alleges that the fire was caused when the train’s drive shaft suddenly disintegrated and caused a spark that ignited the fire. AFM does not allege that LTK designed or supplied the drive shaft. Rather, AFM alleges that the grounding system was negligently designed, permitting the sparking. E.R. 002-003. At present, the fire’s actual cause has not been determined, but again, this Court need not resolve that issue here.

After the fire, the City and SMS entered into an amendment to the Concession Agreement. Under the amendment, the City and SMS agreed to an equal split of the cost to repair the Monorail. E.R. 348, 355-56.

Initially, AFM disputed whether the damaged portion of the Monorail was covered by its policy. SMS filed suit seeking a declaration that the damage was within the policy's terms. *See Seattle Monorail Servs. v. Affiliated FM Ins. Co.*, No. C05-1052-MJP, 2005 WL 2333482, at *1 (W.D. Wash. Sept. 23, 2005).² After the court ruled in SMS' favor, the parties settled, and AFM paid SMS \$3,267,861 to cover damages to the Monorail resulting from the fire. *Affiliated FM II*, 556 F.3d at 920-21.

Acting as subrogee to SMS' rights, AFM then sued LTK to recover the \$3.2 million, alleging that LTK had negligently designed the electrical grounding system. E.R. 003-004. The federal district court granted summary judgment to LTK, holding that AFM's tort action was barred by the economic loss rule as enunciated in *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 124 Wn.2d 816, 826-29, 881 P.2d 986, 992-93 (1994). The court held that, although there was an injury to property, the injured property belonged to the City, not SMS. Therefore SMS' loss was

² As the *Seattle Monorail Servs.* court stated the issue: "The parties ask the Court to determine whether a monorail train is a 'structure' included within the meaning of the 'Demolition and Increased Costs of Construction' clause of the insurance contract." *Id.*

purely economic and not recoverable in tort. *Affiliated FM Ins. Co. v. LTK Consulting Servs., Inc* [*"Affiliated FM I"*]., No. C06-1750JLR, 2007 WL 2156593, at *2-4 (W.D. Wash. July 24, 2007).

AFM appealed to the Ninth Circuit. The Ninth Circuit agreed that SMS' loss was "'economic' or 'commercial' in that SMS suffered harm to its contractually-created economic interest in operating the Monorail." *Affiliated FM II*, 556 F.3d at 921. But the Ninth Circuit held that this Court has not yet "elaborated on how the economic loss rule should apply generally to parties not in privity of contract, where the plaintiff has not received an assignment of claims from a party in privity of contract." *Id.* at 922. Therefore, it certified the question to this Court pursuant to RCW § 2.60.020. *Id.*

ARGUMENT

The United States Court of Appeals for the Ninth Circuit has certified the following question, which this Court has accepted without modification:

May party A (here, SMS, whose rights are asserted in subrogation by AFM), who has a contractual right to operate commercially and extensively on property owned by non-party B (here, the City of Seattle), sue party C (here, LTK) in tort for damage to that property, when A (SMS) and C (LTK) are not in privity of contract?

Affiliated FM II, 556 F.3d at 922. Fairly viewed, the Ninth Circuit's question raises two issues.

First, does the economic loss rule bar SMS' tort claim for property damage, where SMS commercially operates, but does not own, the damaged property? As this brief will show, the answer is that it does.

Second, does the economic loss rule bar SMS' tort action against LTK, where LTK and SMS were not in privity of contract for the services that were the alleged cause of SMS' loss? Again, as this brief will show, the economic loss rule bars the action.

Indeed, this Court's decision in *Berschauer* and its recent decision in *Alejandre v. Bull*, 159 Wn.2d 674, 153 P.3d 864 (2007) have effectively answered the questions, despite the Ninth Circuit's concern. The Court should reject AFM's invitation to undercut their application to these circumstances.

Astonishingly, AFM's brief neither quotes nor mentions the certified question. Indeed, AFM's brief (at 5, emphasis added) erroneously states that the Ninth Circuit "certified this *appeal* to this court." Of course, this is not an appeal, even though AFM's brief treats it as one, raising several issues outside the scope of the certified question.

That should not be permitted. As this Court has repeatedly held, the decision whether or not to answer a certified question is within the

Court's discretion, but "the court lacks jurisdiction to go beyond the question certified." *Broad v. Mannesmann Anlagenbau, A.G.*, 141 Wn.2d 670, 676, 10 P.3d 371, 374 (2000); accord *Kitsap County v. Allstate Ins. Co.*, 136 Wn.2d 567, 577, 964 P.2d 1173, 1178 (1998) ("[W]hen a federal court certifies a question to this court, this court answers only the discrete question that is certified and lacks jurisdiction to go beyond the question presented."); *Louisiana-Pacific Corp. v. Asarco Inc.*, 131 Wn.2d 587, 603-04, 934 P.2d 685, 693 (1997) ("We do not have jurisdiction to go beyond the specific question presented by the Certification Order."); see also *Glaubach v. Regence BlueShield*, 149 Wn.2d 827, 835-36 n.2, 74 P.3d 115, 119 n.2 (2003) ("We are restricted in our review to the four corners of the [certified] question." . . . "We do not reach other statutory or constitutional grounds which might provide relief to the plaintiffs.").

This Court therefore should not address the issues raised by AFM that are outside of the certified question. Accordingly, this brief will address only the issues that are within the certified question's scope..

I. THE ECONOMIC LOSS RULE BARS A TORT CLAIM FOR PROPERTY DAMAGE WHERE THE PLAINTIFF DOES NOT OWN THE DAMAGED PROPERTY BUT HAS A COMMERCIAL OBLIGATION TO PAY FOR ITS REPAIR.

AFM alleges it is SMS' subrogee. Therefore, AFM can have no greater rights than SMS would have had if SMS had sued LTK. *Millican of Washington, Inc. v. Wienker Carpet Serv., Inc.*, 44 Wn. App. 409, 414, 722 P.2d 861, 864 (1986). If SMS had sued LTK for the damage to the Monorail trains, its claim would have been barred by the economic loss rule. So therefore must AFM's suit.

The economic loss rule "marks the fundamental boundary between the law of contracts, which is designed to enforce expectations created by agreement, and the law of torts, which is designed to protect citizens and *their property* by imposing a duty of reasonable care on others." *Berschauer*, 124 W.2d at 821, 881 P.2d at 989-90 (emphasis added). The economic loss rule applies "where the parties could or should have allocated the risk of loss, or had the opportunity to do so." *Alejandre*, 159 W.2d at 687, 153 P.3d at 870.

Here, AFM seeks to recover funds paid for the cost of repairing the Monorail after the fire. As noted in *Berschauer*, tort law generally gives a *property owner* the right to sue for negligently caused damage to its property. AFM characterizes this suit as involving a claim for damage to

SMS' property. But it is undisputed that the damaged property belonged to the City of Seattle, not SMS. SMS simply assumed a contractual obligation to pay for the repairs under the Concession Agreement and its 2005 amendment.

Thus, any loss suffered by SMS was a "contractually-created" economic loss, not damage to its own property, as the Ninth Circuit held in a ruling it did not certify for consideration here. *Affiliated FM II*, 556 F.3d at 921.

Put another way, SMS' expenses of doing business increased after the fire because – as a condition of obtaining the opportunity to profit from running the Monorail System – it agreed to pay some of the cost of repairing the City's property.

AFM's brief devotes a great deal of space to arguing that the Concession Agreement should be characterized as a "lease" that would grant SMS a "property interest" in the damaged equipment. Alternatively, AFM argues that even if the Concession Agreement only created a "license," that would create enough of a property interest to support a tort action. Finally, AFM argues that SMS' ability to obtain insurance on the property proves that it had an interest in the property. None of those arguments has merit.

First, the Concession Agreement is not a lease. It is *sui generis*, as the federal district court properly held. *Second*, even if the Concession Agreement were a lease, that would not confer on SMS a “property interest” on which to base a tort suit for damage to the City’s property. *Third*, SMS purchased the insurance because the Concession Agreement required it to bear the expense of insurance premiums, not because it had a property interest in the Monorail system. AFM argues that, because it agreed to write the policy for SMS, its own agreement establishes that SMS must have had an insurable interest had in the Monorail property. That self-serving argument cannot withstand scrutiny.

**A. The Concession Agreement Is *Sui Generis*,
Not a Lease.**

The federal district court held that “although not a perfect analogue, the relationship between [SMS] and the City under the Agreement is closer to that of a licensor/licensee, than landlord/tenant.” *Affiliated FMI*, 2007 WL 2156593 at *3. AFM appears to argue that the Concession Agreement must be one or the other, but the world of contracts contains more than those two categories.

Certainly the Concession Agreement is not a lease. AFM points to nothing in it that grants or purports to grant any property interest to SMS. The terms “lease,” “rent,” “lessor,” “lessee,” “landlord,” “tenant,” “grant,”

“convey,” or any other words typically used in leases, do not appear in the document.

Rather, the relationship is fundamentally commercial: SMS was hired to operate the Monorail, maintain it (up to the amount of the annual maintenance expenses cap), collect the fares, and pay part of its revenue to the City. To be sure, operating the Monorail requires access to the trains, racks, and other property. But the Concession Agreement’s overriding purpose is providing for outsourced operational services, not a conveyance of property.

The City owns the Monorail system, as all parties agree – including the City itself.³ Though SMS was required to pay the cost of insurance, the City was to be the loss payee, reflecting the party on whom the true loss would lie.

AFM cites *Barnett v. Lincoln*, 162 Wash. 613, 299 P. 392 (1931). But there, this Court held that, to be regarded as a lease, an agreement must “purport[] to yield up *exclusive possession* of the premises against the world, including the owner.” 162 Wash. at 619, 299 P. at 394 (emphasis added); *see also Lacey Nursing Center, Inc. v. State of*

³ See E.R. 015, the Declaration of Seattle Assistant City Attorney Helaine Honig, ¶ 11 (“The City of Seattle is the only entity holding an ownership interest in the monorail system and its trains, including all property damaged as the result of a fire occurring on May 31, 2004 . . .”).

Washington, Department of Revenue, 103 Wn. App. 169, 183, 11 P.3d 839, 846 (2000) (at common law, “[a] tenant’s primary right is to have exclusive possession and use of real property.”). Here, however, nothing in the Concession Agreement grants SMS exclusive possession of the Monorail trains, tracks, or buildings. Rather, the Concession Agreement grants only the exclusive right to operate and maintain the trains, while not excluding the City or, indeed, any person who pays the fare. Moreover, the City had the right, without obtaining SMS’ approval, to hire LTK to examine and make recommendations with respect to the Monorail system.⁴

In response, AFM argues that landlords “typically maintain keys for properties they rent” without destroying the character of the lease. (AFM Br. at 18.) But clearly the Concession Agreement has conveyed far less than exclusive possession, and the City’s rights are far greater than simply maintaining keys. The Concession Agreement embodies a

⁴ AFM argues that the City did not in fact have that right. (AFM Br. at 18.) Again, however, the Ninth Circuit has already ruled on that issue, holding that “[t]he Agreement granted to SMS the right to operate the Monorail System, but retained for the City the right to enter the property and to adjust operation of the Monorail System as necessary.” *Affiliated FM II*, 556 F.3d at 920. As noted above, Section XIX(A) of the Concession Agreement gives the City the right to inspect, repair, and improve the Monorail System at its discretion. E.R. 095.

complex business relationship, the focus of which was operations, not ownership. It is not a lease in any usual sense of the term.

SMS had the ability to bargain for a different type of relationship, including an assignment of the City's claims against third parties for property damage. Or it could have bargained for a higher share of the receipts to compensate for its financial obligations. Or it could have refused to enter into the Concession Agreement unless the City agreed to grant it a lease to the Monorail system. But it did not do so. Trying to fit this many-sided peg retroactively into a square hole simply doesn't work.

**B. Even If the Concession Agreement
Could Be Characterized as a Lease,
That Would Not Help AFM's Position.**

AFM simply assumes, without citation to any authority, that a lessee has the right to sue third parties in tort for any damage to the landlord's property. But while a lessee (or even a licensee) may have the right to sue third parties for some wrongs, suing for damage to the landlord's property is not one of them.

Initially, *Barnett* did not hold that the agreement in that case conferred any right to file a tort action. While it characterized the agreement as a lease, the matter in issue was whether, by entering into the agreement, the City had violated a statute requiring it to obtain a bond

from certain lessees. 162 Wash. at 616-17, 299 P. at 393-94. Nothing before the Court required it to rule on whether the agreement would have supported a tort suit by the tenant for damage to the premises.

Moreover, AFM's citation to *Robinson v. Avis*, 106 Wn. App. 104, 22 P.3d 818 (2001) is mystifying, because that case says nothing about defining a lease or allocating the right to sue for damage to the vehicle.

Nevertheless, AFM's own illustration of a car rental shows why its lease argument must fail. Suppose a car rental company hires a mechanic to fix a car's brakes, and the brakes fail while the renter is driving, causing the car to hit a tree. Under AFM's theory, the renter would have a tort claim against the mechanic for the damage to the car.

That makes no sense. Though property was damaged, it was not the renter's property. If anyone has a claim against the mechanic for damage to the car, it is the rental company that owns it. The renter has suffered no loss to his or her property. That can be shown by the fact that an *owner* can sue for the cost of repair or the car's diminution in value even if it chooses not to use the judgment to repair the vehicle. If the renter actually had any property interest in the car, it too would be allowed to sue and keep the judgment. But the renter cannot pocket the judgment while the rental company still has a damaged car. The renter has a "loss"

only if – based its negotiated deal with the rental company – it actually pays to make the repair.⁵

Thus, even assuming the car rental agreement were a lease, the renter has no property interest in the damaged car that would allow it to sue and keep the judgment. Any obligation it may have to pay for the cost of repairs is an economic loss assumed by contract, not a property loss that could support a direct tort suit against the mechanic.

Here, even if the Concession Agreement were a lease, SMS' position is like that of the car renter. The damaged monorail trains and tracks belong to the City, which suffered the *property* loss. To the extent SMS had an obligation to pay for the repairs, that was a negotiated economic obligation assumed by contract, not a transfer of any interest in the City's property.

AFM also argues that, even if the Concession Agreement were characterized as a license, Section 521(2) of the RESTATEMENT (FIRST) OF PROPERTY (1944) provides that a license agreement “confers a sufficient

⁵ Notably, though car rental agreements are typically non-negotiable forms, the responsibility for damage is typically the one thing over which renters do bargain. For a lower price the renter accepts financial responsibility for all damage to the car, while for a higher price the rental company agrees to pay, even when the damage is the renter's own fault. *See, e.g., Wayne v. Staples, Inc.*, 135 Cal. App. 4th 466, 37 Cal. Rptr. 3d 544, 551 (Cal. Ct. App. 2006) (describing the standard “collision damage waiver” option in car-rental contracts).

legal interest in property to sustain a tort action against a third party that damages that property.” (AFM Br. at 13.) But Section 521(2) – which has not been carried over to the Second or Third RESTATEMENTS – says no such thing, nor does AFM cite any case law applying Section 521(2) to uphold a licensee’s tort action for the cost of repairing damaged property. Indeed, AFM does not even bother to quote the RESTATEMENT section and explain how it could apply here.

Section 521(2) provides: “A licensee is entitled to protection against interference by third persons with the use privileged by the license to the extent to which the license gives him possession as against such persons.” The language plainly deals with third persons who interfere with exclusive rights of possession a license may grant. It says nothing about a right to sue in tort for the cost of repairing damage to the property. The only Washington case that has applied Section 521(2) did so only to protect a licensee’s exclusive right to possess a boat slip. *McInnes v. Kennell*, 47 Wn.2d 29, 36, 286 P.2d 713, 717 (1955). There was no claim for property damage. Moreover, the licensee had *exclusive* possession, which SMS does not.

Another example shows why AFM’s license argument must fail. A hotel lodger is usually classed as a licensee. *See Lacey Nursing Center*, 103 Wn. App. at 183-84, 11 P.3d at 846, *quoting* WILLIAM B. STOEUBUCK,

17 WASHINGTON PRACTICE: REAL ESTATE: PROPERTY LAW (1995) § 6.3, at 296. But whether a lodger “renting” a hotel room is a licensee or a tenant, surely the lodger cannot have an action for damages against a third party who negligently destroys the hotel’s property that the lodger has the right to use in the room – the bed, the television, the desk, etc. The hotel owns that property and has the sole right to sue for the cost of its replacement or repair.

In sum, it makes no difference whether the Concession Agreement is characterized as a lease, a license, or neither. The property that was damaged – the Monorail cars and tracks – was not SMS’ property. SMS’ obligation to pay some of the repair cost (only 50 percent under the fifth amendment to the Concession Agreement) was a commercial obligation it undertook by contract, not the reflection of any ownership interest in the damaged property.

C. SMS’ Purchase of Property Insurance on the Monorail Does Not Show that It Had a Property Interest in the Monorail.

The Concession Agreement required SMS to purchase property insurance on the Monorail for the City’s benefit. *Affiliated FM II*, 556 F.3d at 920; E.R. 81-82. In other words, among the expenses allocated to SMS under the Concession Agreement was the cost of obtaining

insurance, but the City was to be the loss payee under the policy if the Monorail was damaged. *Id.* That provision therefore allocates to SMS a cost of doing business, not an interest in property.

Second, AFM's argument is entirely self-serving. It wrote the policy and now argues that, because it wrote the policy, SMS must have had an insurable interest. Whether SMS had a legally insurable interest has never been tested adversarially.⁶ AFM's own decision to accept premium payments from SMS is hardly evidence that SMS owned a property interest in the Monorail. Indeed, by agreeing to make the City the loss payee, AFM and SMS acknowledged otherwise.

**II. THE ECONOMIC LOSS RULE APPLIES HERE,
EVEN THOUGH LTK AND SMS WERE NOT
IN PRIVITY OF CONTRACT.**

In Washington, contractual privity between the plaintiff and the defendant is not a necessary element of the economic loss rule. Contrary to AFM's argument, the economic loss rule is not simply a bar to tort recovery where the parties already have a contract remedy. Rather, as this Court has made clear, the economic loss rule bars actions in tort where the defendant's duty of performance arises solely from a contract and the

⁶ As noted above, SMS brought a coverage suit against AFM, but the issue in that case was whether the specific damaged elements of the Monorail were covered by the policy's terms. *Seattle Monorail Servs.*, 2005 WL 2333482, at *1.

plaintiff claims an economic injury from the contract's inadequate performance. This Court has already held as much in *Berschauer*. AFM's attempts to avoid *Berschauer* are meritless.

**A. In *Berschauer*, This Court Held That
The Economic Loss Rule Bars a Tort Action
Against an Engineer Not in Privity
with the Plaintiff.**

In *Berschauer*, this Court unequivocally held that the economic loss rule applies to plaintiffs who are not in privity with the defendant but who claim economic losses from the breach of a contract between the defendant and a third party. There, a property owner hired an architect to design a building, and the architect subcontracted with an engineering firm to provide structural engineering services. The property owner also retained a testing firm to inspect the construction work. The property owner separately hired a general contractor to build the building that the architect and the engineer had designed. The general contractor had no contractual privity with the architect, the engineer, or the inspector. After finishing the building, the general contractor sued the architect, the engineer, and the inspector in tort, alleging that their negligence had increased the contractor's costs by \$3.8 million. *Berschauer*, 124 Wn.2d at 818-20, 881 P.2d at 988-89.

The lack of privity between the plaintiff and the defendants was directly before this Court, which characterized the issue on appeal as follows: “The primary issue is whether the economic loss rule prevents a general contractor from recovering purely economic damages in tort from an architect, an engineer, and an inspector, *none of whom were in privity of contract with the general contractor.*” *Id.*, 124 Wn. 2d at 821, 881 P.2d at 989 (emphasis added).

In *Berschauer*, as here, the plaintiff argued that the economic loss rule should not apply because the plaintiff had no contract with the defendants and thus no remedy for breach of contract. Therefore, the plaintiff argued, its proper basis for bringing a claim against the architect, engineer, and the inspector was an action in tort. *Id.*, 124 Wn.2d at 827-28, 881 P.2d at 993.

This Court rejected that argument, holding that “[T]here is a beneficial effect to society when contractual agreements are enforced and expectancy interests are not frustrated. In cases involving construction disputes, the contracts entered into among the various parties shall govern their economic expectations.” *Id.*, 124 Wn.2d at 828, 881 P.2d at 993. Enforcing the contractual nature of commercial relationships is “efficient and fair.” *Id.* As this Court explained:

If tort and contract remedies were allowed to overlap, certainty and predictability in allocating risk would decrease and impede future business activity. The construction industry in particular would suffer, for it is in this industry that we see most clearly the importance of the precise allocation of risk as secured by contract. The fees charged by architects, engineers, contractors, developers, vendors, and so on are founded on their expected liability exposure as bargained and provided for in the contract.

Id., 124 Wn.2d at 826-27, 881 P.2d at 992. Thus, allowing a tort remedy to fill gaps in commercial relationships interferes with freedom of contract and discourages parties from efficiently allocating their risks before any harm occurs.

Here, the absence of privity between LTK and SMS is not a reason to abandon the economic loss rule. Rather, it is a reason to embrace the rule. SMS, like the contractor in *Berschauer*, had the opportunity to control its financial exposure to the property owner, with which it had contracted. It elected to assume financial exposure for repairs of all sorts, no matter who caused the damage. SMS also elected to agree that the City would have the right to inspect, repair, and improve the Monorail system at its own discretion. SMS therefore agreed to assume full exposure for the cost of repairing damage caused by the City's exercise of its right to inspect, repair, and improve the Monorail.

LTK's duty of performance was governed by its contract with the City. If LTK breached that contract, the City had a remedy. But LTK had no additional legal duty to SMS, whose presence at and involvement with the Monorail were defined by its contract with the City. So all three parties were related by their web of contracts and nothing more. And, as this Court observed in *Berschauer*, LTK's fee was "founded on [its] expected liability exposure as bargained and provided for in the contract." 124 Wn.2d at 827, 881 P.2d at 992.

Courts in other states have reached the same result. *See, e.g., BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66, 73-74 (Colo. 2004) (applying economic loss doctrine to bar tort claims, even without contractual privity, citing *Berschauer* with approval); *SME Indus., Inc. v. Thompson, Ventulett, Stainback & Assocs., Inc.*, 2001 UT 54, 28 P.3d 669, 681-82 (Utah 2001) (same, citing *Berschauer* with approval); *see also Plourde Sand & Gravel Co. v. JGI Eastern, Inc.*, 154 N.H. 791, 917 A.2d 1250, 1254-56 (N.H. 2007) (same); *Fireman's Fund Ins. Co. v. SEC Donohue, Inc.*, 176 Ill. 2d 160, 679 N.E.2d 1197, 1199-1200 (Ill. 1997)

(same); *Daanen & Janssen, Inc. v. Cedarapids, Inc.*, 216 Wis. 2d 395, 573 N.W.2d 842, 849-50 (Wis. 1998) (same).⁷

This is not a sympathetic case presenting a harm without a remedy. If a landlord hires a plumber, whose faulty work makes the premises uninhabitable, that is normally a breach of the landlord's obligation to provide habitable premises, and normally the tenant can sue the landlord for breaching the lease. But if the tenant has agreed to limit its recourse against the landlord, or for business reasons decides not to sue the

⁷ In *Daanen & Janssen*, the Wisconsin Supreme Court rejected the same fairness argument AFM makes here. There, the plaintiff had purchased a machine part from a distributor, which expressly disclaimed any warranty. When the part failed, the plaintiff therefore could not sue the distributor and brought a tort suit against the manufacturer instead. Even though the plaintiff argued that, unless it could sue the manufacturer in tort, it would be left without a remedy for an expensive loss, the court held that the lack of privity between the plaintiff and the manufacturer was no bar to applying the economic loss rule:

Daanen first argues that because it lacked privity of contract with Cedarapids, application of the economic loss doctrine would leave it with no alternative remedy against Cedarapids to recover its economic losses. This argument does not persuade us that privity should be an element of the economic loss doctrine. As explained above, the economic loss doctrine is aimed at encouraging commercial parties ex ante to negotiate for warranty protection or to take other steps, such as purchasing insurance, to protect their purely economic interests. We will not allow ex post claims of fairness to temper our application of the doctrine here.

573 N.W.2d at 850.

landlord, there is no equitable basis for the tenant demanding a remedy from the plumber. The tenant should be held to its bargain.

Here, SMS bargained to pay for repairs even if the damage was not SMS' fault. Again, it could have struck a different deal, or it could have decided the deal was not worth making. Moreover, after the fire, SMS negotiated with the City for the fifth amendment to the Concession Agreement, which allocated 50 percent of the repair cost to the City. SMS' failure to obtain full reimbursement from the City is its own bargain, to which it should be held.

Moreover, AFM's position would lead to undesirable and absurd results. Tort damages are generally more extensive than contract damages. *See, e.g., Washington Water Power Co. v. Graybar Elec. Co.*, 112 Wn.2d 847, 852, 774 P.2d 1203 (1989) ("Because of the presence of liability limitation and warranty disclaimer clauses in the sales documents executed by WWP and Graybar, therefore, WWP understandably would prefer to avoid the sales law rules [and sue in tort].") If the economic loss rule did not bar SMS' tort suit, it could sue LTK in tort at the same time the City could sue LTK for breach of contract. That would give SMS the possibility of a better litigation result than the City could achieve in a suit against LTK over the exact same loss. But there is no valid policy reason why that should happen.

The extent of the remedy should not depend on who is suing over the same loss, a party in privity or one not in privity. The contractual risk LTK undertook should not be expanded by allowing SMS (and AFM) to circumvent the contract and ignore the bargain under which LTK agreed to provide its services. To return to AFM's car rental analogy, if the mechanic who fixed the brakes had negotiated with the rental company a \$1,000 limitation on its liability, there could be no justification for permitting the renter to sue the mechanic in tort for the car's full value. Applying the economic loss rule in such situations avoids that commercially unwarranted end-run around the contract.

B. AFM's Attempts to Avoid *Berschauer* Are Meritless.

Remarkably, AFM does not attempt to distinguish *Berschauer*. Instead, it relies on a Court of Appeals decision in *Baddeley v. Seek*, 138 Wn. App. 333, 156 P.3d 959 (2007), which simply states, with no explanation or citation to authority, that the economic loss rule does not apply to parties not in privity. *Id.*, 138 Wn. App. at 339, 156 P.3d at 962 (“Since no contract relationship exists between STI and the Baddeleys, the economic loss rule does not apply.”).

That statement cannot be reconciled with this Court's holding in *Berschauer*. Indeed, as a more recent Court of Appeals case observed,

Berschauer expressly rejected the argument that the economic loss rule should not apply where the plaintiff had no contractual privity with the defendant. *Carlile v. Harbor Homes, Inc.*, 147 Wn. App. 193, 206, 194 P.3d 280, 286 (2008). Nor did *Baddeley*, a Division III case, distinguish or purport to overrule *Carlson v. Sharp*, 99 Wn. App. 324, 330, 994 P.2d 851, 854 (2000), an earlier Division III case, where the court applied the economic loss rule to bar the tort claim of a homeowner against a consulting engineer with whom the homeowner was *not* in contractual privity.

Baddeley is of course not binding authority here. Its holding is foreclosed by *Berschauer*. Nor, given its lack of reasoning, is it persuasive. This Court should reject it.

In the Ninth Circuit, AFM attempted to distinguish *Berschauer* by arguing that the plaintiff did have privity with the defendant because, after the *Berschauer* suit was filed, the property owner assigned to the plaintiff its contract claims against the architect, engineer, and inspector. But in *Berschauer* this Court did not in any way rely on that distinction as the basis for its holding. Indeed, in the passage quoted above, 124 Wn.2d at 826-27, 881 P.2d at 992, it specifically addressed the plaintiff's *direct* tort claims, not the assigned claims. In any event, AFM does not press that distinction here.

Finally, AFM argues that the economic loss rule only prevents a party from suing in tort when that party already “has an adequate remedy for breach of contract.” (AFM Br. at 23.) In support, AFM cites *Washington Water Power*, 112 Wn.2d at 851-52, 774 P.2d at 1202-03. But that proposition appears nowhere in *Washington Water Power*. Nor is it consistent with this Court’s later holdings in *Berschauer* and *Alejandre*. In neither case was the *actual* existence of an adequate contract remedy the basis for barring the tort claim. Indeed, neither plaintiff had any contract remedy – in *Berschauer* because there was no contractual privity and in *Alejandre* because the contract did not allocate the risk at issue.

As this Court’s jurisprudence has made clear, the economic loss rule does not depend on the existence of an actual adequate contract remedy. This Court’s recent decision in *Alejandre* further emphasizes that “[t]here is no requirement that a risk of loss must be expressly allocated in a contract before a tort claim based on that loss will be precluded under the economic loss rule.” 159 Wn.2d at 677-78, 153 P.3d at 866. That further undercuts the significance of privity, since the issue is not whether the parties actually bargained over a risk but, rather, it is whether the risk was of the sort that a party could have bargained to protect against: “the economic loss rule applies where the parties could or should have allocated the risk of loss, or had the opportunity to do so.” *Id.*, 159 Wn.2d

at 687, 153 P.3d at 870. Here, the Concession Agreement assigns the risk of repair costs to SMS without giving SMS any rights to pursue the City's contractors. That is the deal SMS and AFM must abide by now.

Further, Justice Chambers' concurrence in *Alejandre*, which AFM cites in support of its position, expressly notes that, "[o]ver the years, the economic loss rule has been applied in cases where there was no privity of contract between the parties. This is because there are types of injuries for which the law gives no remedy, and injuries to third parties stemming from someone else's breach of contract are often (though not always) of that type." *Id.*, 159 Wash. 2d at 695 n.2, 153 P.3d at 874 n.2 (Chambers, J., concurring).

Fundamentally, the economic loss rule provides an incentive in commercial relationships to allocate risk efficiently by eliminating a tort remedy for risks the parties failed to allocate. The rule is intended to "preserve the incentive to adequately self-protect during the bargaining process. If we held to the contrary, a party could bring a cause of action in tort to recover benefits they were unable to obtain in the contractual negotiations." *Berschauer*, 124 Wash. 2d. at 827, 881 P.2d at 992-93 (citation omitted).

Again, SMS could have bargained with the City to deny the City the right to make inspections, repairs and improvements. Or it could have

bargained to require the City to bear sole financial responsibility if repairs and improvements made by the City went wrong. Or it could have bargained for the right to become a party to every City contract for inspections, repairs or improvements. But it did none of those things, which might have offered protection here.

Neither the existence of an adequate contract remedy, nor even of a contract at all between the parties, is necessary for the economic loss rule to apply here. LTK's duty of care was created by its contract with the City, and that contract created no independent duty to avoid SMS' or AFM's economic loss. SMS' bargain with the City required it to pay for repairing the City's property so long as it was operating the Monorail. Presumably SMS believed that was a deal worth making.

III. AFM'S OTHER ARGUMENTS ARE OUTSIDE THE QUESTION CERTIFIED, AND THIS COURT LACKS JURISDICTION TO ADDRESS THEM.

As noted above at the outset, this Court has repeatedly held that it lacks jurisdiction to address issues outside the question certified by a federal court. But AFM treats this as an appeal, raising essentially every issue it had raised before the Ninth Circuit, whether certified to this Court or not. Indeed, the last 17 pages of AFM's brief argue issues that cannot

even remotely be teased out of the question certified by the Ninth Circuit here.

For example, AFM argues that SMS' loss was not an economic loss within the meaning of the rule (AFM. Br. at 23-31), and it argues that the economic loss rule in Washington should yield to different interpretations applied by courts in California and Florida. The Ninth Circuit did not raise those issues in its certified question. This Court therefore has no jurisdiction to address them, and it should not do so.

CONCLUSION

The economic loss rule is well suited for cases like this, where the parties' web of contracts established their respective risk allocations. This Court has all but decided the question the Ninth Circuit has certified: May SMS (or AFM, as its subrogee) have a tort claim against LTK for damage to the City's property, where SMS and LTK were not in privity of contract? The answer is no, as *Berschauer* and *Alejandre* make clear.

RESPECTFULLY SUBMITTED this 8th day of April, 2009.

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Please find attached the Response Brief of LTK Consulting Services, Inc. on Certified Question from the United States Court of Appeals for the Ninth Circuit Cause No. 07-35696, and a Certificate of Service.

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