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IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

TIMOTHY JACKOWSKI and ERI TAKASE, Husband and Wife,

Appellants,

v.

DAVID BORCHELT and ROBIN BORCHELT, Husband and Wife;
HAWKINS POE, INC., dba COLDWELL BANKER HAWKINS-POE
REALTORS; HIMLIE REALTY, INC., VINCE HIMLIE, Broker for
Windermere Himlie Real Estate, Real Estate Brokers, and ROBERT
JOHNSON and JEFF CONKLIN, Real Estate Agents

Respondents.

RESPONSE TO AMICUS BRIEF BY APPELLANTS JACKOWSKI

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I. INTRODUCTION

As Emerson wrote, "a foolish consistency is the hobgoblin of little minds." The Realtor parties in this case, including the Amicus, are asking this Court to impose a foolish consistency on real estate transactional law in the State of Washington. This Court should decline this invitation and, instead, clarify the parameters of the economic loss rule it has already set in previous cases.

Proper consistency treats like things the same. Foolish consistency treats unlike things the same without regard to their relevant differences from each other. The Realtor parties ask this Court to impose rules that treat real estate *professionals* in the same manner as other, non-professional participants in real estate transactions, without regard to the relevant differences between professionals and nonprofessionals. Similarly, the Realtor parties ask this Court to treat *real estate* professionals the same as *construction design* professionals without regard to the relevant differences between construction and real estate sales and the relevant differences between the scope of the ethical duties of the two professions. For instance, while *construction design* professionals' obligations extend only to their clients, RCW 18.86 specifically extends real estate professional duties to all participants in the transaction.

In essence, the Realtor parties are asking this Court to abolish professional malpractice as an actionable theory at law. They argue that failing to do so will cause uncertainty in real estate transactions, leading to commercial and social disruption. In fact, the opposite is true. Real estate transactions take place in a context of professional obligations enforced by professional malpractice liability. Unfettering such transactions from the legal context of professional malpractice law, especially if the Court casts a shadow over the continuing viability of professional malpractice as a legal theory in general, would be a change in the law, producing far more uncertainty and disruption than the alternative. The Court of Appeals properly understood the purpose, the context, and the limits of the economic loss rule, and this Court should affirm that decision.

II. SUMMARY OF ARGUMENT

The economic loss rule bars a plaintiff from recovering *tort* damages in an *action at law* for *purely economic losses* when the parties' relationship, rights and duties *arise exclusively from and are governed exclusively by contract*. Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007); Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987). This is the keystone of the economic loss rule. The Realtor parties ignore the limitations and nuances of the rule.

The key question in this context is whether a professional/client relationship is a relationship governed exclusively by contract (whether the rights and duties in that relationship arise exclusively from the contract). If so, the economic loss rule applies. If not, the economic loss rule does not apply. There is no inconsistency in this distinction.

In the real estate professional context, there is an easy way to see that the professional relationship does not arise exclusively from the contract. The statute regulating the real estate profession imposes ethical duties on real estate professionals to persons with whom the real estate professional has no contract (for instance, disclosure to all parties of material facts apparent to the licensee (RCW 18.86.030 (e).) These are special professional duties owed by *real estate* professionals as opposed to both the other, nonprofessional parties in real estate transactions (who have no professional obligations) and by practitioners of other professions (such as architects and engineers, which professions have no similar third-party obligations).

Because the real estate professional relationship is not exclusively a creature of contract, it is not subject to the economic loss rule. Specifically, an aggrieved party can sue a real estate professional for malpractice.

Alternatively, at least with regard to Hawkins Poe (the party in support of which the Amicus was filed), even if this Court interprets real estate the professional relationship as purely contractual, by agreeing to provide professional services to the Jackowskis, Hawkins Poe undertook to provide legally defined services (defined, at a minimum, by the statute governing the real estate profession (RCW 18.86). That statute imposes duties of good faith and reasonable skill and care. RCW 18.86.030 (a) and (b). Failure to satisfy those professional requirements is the basis for a professional malpractice claim. However, perhaps there is some reason to understand such professional obligations as implied-in-law terms of the professional contract. If so, an action for breach of them (malpractice) would be a contractual, not a tort, cause of action. In such case, the economic loss rule would not bar them because the economic loss rule does not bar contract claims. (However, there is good reason not to entertain such a recasting of professional obligations into contractual terms. Insurance, including errors and omissions (malpractice) insurance generally contains a waiver of "claims for breach of contract." If malpractice claims are reconceived as claims for breach of contract, the entire system of malpractice insurance would have to be reformed -- possibly by requiring bonds instead of insurance).

III. ARGUMENT

A. **The Economic Loss Rule Does Not Require that All Parties Sued in a Case Involving a Contract be Treated Identically**

There are three potential kinds of parties to litigation in a circumstance that involves a contract: (1) parties whose relationship is defined entirely by the contract (ordinary, nonprofessional contracting parties such as the buyer and seller in a real estate transaction); (2) parties whose relationship is noncontractual (such as an intermeddling third party who interferes with a contractual relationship, or a person making a respondeat superior claim for torts relating to activities of a person with an employment contract); and (3) parties who have a contractual relationship, but who also have other relevant duties which provide for an independent tort claim (such as a claim against a contractor who rear-ends his customer's car in the customer's driveway (general rule of the road duties) or a malpractice claim (professional duties which have a source and significance independent of the contract)). It would be as foolish to apply the same rules to these three categories of relationships (as all the Realtor parties urge) as it would be to have an unpredictable and *ad hoc* system of rules that treat similarly situated parties differently. Fortunately, the economic loss rule commits neither act of foolery.

The economic loss rule bars a plaintiff from recovering *tort* damages in an *action at law* for *purely economic losses* when the parties' relationship, rights and duties *arise exclusively from and are governed exclusively by contract*. Alejandre v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007); Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987). This formulation of the rule provides all the tools needed to treat like-kind parties the same and unlike-kind parties differently. For ordinary, nonprofessional parties to a contract, the relationship, rights, and duties arise exclusively from contract, so the economic loss rule applies to bar *legal claims for economic loss damages*. For nonparties to the contract, the relationship, rights and duties are all independent of the contract and support a separate tort action, although the contract may be the subject matter of the action (as in a wrongful interference claim) or have some other legal significance (as in the case of *respondeat superior*), so the economic loss rule does not apply. Finally, for mixed cases, such as professional relationships, the economic loss rule does not apply because, although the relationship, rights and duties arise *in part* from the contract, they do not arise *exclusively* from the contract.

Despite the utility of the economic loss rule properly understood with these distinctions, confusion has arisen in its application. This Court

should clarify the scope and application of the economic loss rule by following similar scoping decisions from Texas, which provide clarity to the rule and which have been implemented without apparent economic or social disruption of the kind feared by the Realtor parties. Rather than using the phrase, “*arise exclusively from and are governed exclusively by contract*” in defining the economic loss rule, the Texas Courts apply an exception to the rule when the action is based on an “independent tort.” Southwestern Bell Tel. Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex. 1991); Crawford v. Ace Signs, Inc., 917 S.W.2d 12 (Tex. 1994). That is, when a tort action is independent of the contract in a factual or legal sense, then it is not subject to the economic loss rule.

Texas has applied this principle in the following types of cases:

Fraud in the Inducement. The “legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.” Formosa Plastics Corp. USA v. Presidio Engineers & Contractors, Inc., 960 S.W.2d 41, 46 (Tex. 1996). This is distinct from “Fraud in the Performance”, which is not independent as it occurs in the context of contractual performance. Thus, torts of misrepresentation and fraud can be neatly and readily divided for purposes of application of the economic loss rule, and parties can simultaneously be protected from

being tricked into contracts and be required, when entering contracts, to consider and allocate risk of deceit by the other party in performance.

Injury to Other Property. In Montgomery Ward & Co. v. Scharrenbeck, 204 S.W.2d 508 (Tex. 1947), the Supreme Court noted that a repairman whose negligence resulted in burning down the plaintiff's home could be sued for negligence, even though he had a contract with the plaintiff. This analysis is similar to that routinely done in evaluating the distinction between "breach of contract" and "damage to other work" when determining insurance coverage in construction cases, so implementation of such a rule would not be unfamiliar or difficult.

Professional Negligence and Malpractice. This is the exception, recognized in Texas, that is of particular importance in this case (at least with regard to the Realtor Parties). In Texas, the DeLanney Court observed, "Of course, some contracts involve special relationships that may give rise to duties enforceable as torts, *such as professional malpractice*" (emphasis added). DeLanney, supra, at 494. Thus, Texas has specifically recognized an exception for professional malpractice claims as distinct and independent from breach of contract claims, and has not suffered any commercial or social harm as a result. On the contrary,

such recognition has preserved the traditional and deep-seated understanding of professional duties and professional malpractice.

This Court should follow the Texas formulation, clarifying and applying the critical distinction between "dependent risks" (risks associated entirely with and arising exclusively from the terms of a contract and relating to a party's alleged misperformance of some contractual obligation -- which are properly subject to contractual risk allocation negotiations) and "independent torts", which involve duties with a source other than the contract, either in special professional duties (as here) or in general tort duties (as in the case of a contractor crashing his truck into his customer's car.)

B. Berschauer Phillips Does Not Abolish Professional Malpractice as a Cause of Action in Washington State

There is a general tort liability for professionals, even if the profession operates within a commercial or contractual context. This liability is articulated at Section 552 of the Restatement (Second) of Torts, which provides:

Information Negligently Supplied for the Guidance of Others

(1) One who, in the course of his business, profession, or employment, or in any other transaction in which he has a

pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused by them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and

(b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

This Court has applied this rule, although it refused to do so in Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1, 124 Wn.2d 816, 881 P.2d 986 (1994). However, the Berschauer/Phillips decision was part of a body of national caselaw limiting claims in the construction (specifically in the commercial construction) context. A review of the national authority shows that this limitation on malpractice claims has not been extended outside the construction context in any state, as the Realtor parties seek to have this Court do by replicating the limitation in the real estate context. Such an expansion is uncalled for.

Further, a close reading of the Berschauer/Phillips decision shows that the result was over-determined and need not have applied the

economic loss rule or wholly rejected Section 552 of the Restatement.

Berschauer/Phillips involved a claim by a contractor building a school for the Seattle School District. Allegedly, the design documents procured by the School District from its architects and engineers were defective.

Berschauer/Phillips sued the School District on the warranty of plans and specification, but it also sued the design professionals even though it had no contract or other direct professional relationship with those design professionals.

This lack of a professional relationship was the critical factor in both the Berschauer/Phillips decision and the subsequent and similar decision in Carlson v. Sharp, 99 Wash. App. 324, 994 P.2d 851 (1999). Unlike real estate professionals, the professional obligations of architects and engineers do not extend beyond the persons with whom they have professional relationships (professional service contracts). Critically, neither Berschauer/Phillips nor Carlson v. Sharp ruled that the person to whom negligent design services were provided had no remedy in malpractice against the design professional. That is, even in the design context, when there is a direct professional relationship (as between Hawkins Poe and the Jackowskis), there is a malpractice claim when the professional breaches a professional duty of care.

Therefore, applying Section 552 of the Restatement, a general contractor hired by an owner for whom a design professional did work is not a person to whom the design professional provided information or services. Thus, the limitation on the Restatement is not a wholesale rejection of it (and it has been applied elsewhere), rather the Berschauer/Phillips decision and its progeny merely limit the application of Section 552 *in the construction context* to the direct recipients of professional services, refusing to apply the term that a professional duty flows to third parties which the design professional "knows that the recipient intends to supply" with the fruits of the design professional's work.

Real estate professionals are more like attorneys than they are like design professionals with regard to their role in real estate transactions. In fact, under the RCW 18.85.011 (16), the scope of services which are offered by real estate professions are primarily contract drafting and negotiation duties that were historically considered to be professional legal work. For that reason, real estate professionals are considered to be limited practitioners of law, with a practice limited to the real estate context. Thus, it makes sense to analogize their professional duties to those of a lawyer, rather than to those of a design professional.

Unlike design professionals, and like real estate agents, lawyers owe duties to persons with whom they have no direct professional service contract (for instance, the heirs of an estate) and face malpractice liability for mistakes caused by lack of proper professional care when they violate such third-party duties.

C. There is No Inconsistency in the Court of Appeal's Decision and it Does Not Make the Economic Loss Rule Illusory

Applying proper and nuanced distinctions does not make a legal rule illusory or inconsistent. In fact, failure to apply such distinctions makes a rule unwieldy, ham-handed, and likely to produce unforeseen and harmful results. Such would be the case if this Court took up the Realtor parties' suggestion that the economic loss rule should be interpreted to overrule several centuries of professional regulation cases by invalidating the very concept of malpractice.

There is a distinction between a profession and a mere occupation. Special standards of care lie at the heart of that distinction. Professionals are professionals *because* they can be sued for malpractice, rather than just for breach of contract.

The Realtor parties, including the Amicus, argue that the economic loss rule provides that, whenever there is a contract, there is no longer any

possibility that a party could commit an actionable tort. This argument is wrong. The error arises from the failure to recognize that while contracts impose special duties on the contracting parties, it does not relieve them of the duties they already had going into the transaction (duty to drive reasonably and, for professionals, the duty to practice with due professional care). Such pre-existing duties are not “assumed only by agreement.” See Alejandre, 159 Wn.2d at 682. They pre-exist the contract, continue to exist after the final performance of the contract, and would exist even if the contract were never entered.

Realtors have struggled for recognition as a profession, seeking the social status that comes from such recognition. They have achieved that goal, and are regulated as a profession in the State of Washington. Hoffman v. Connall, 108 Wn.2d 69, 736 P.2d 242 (1987) (real estate agents are professionals like lawyers, chiropractors, and doctors). That regulation imposes a burden -- the burden of being held to a professional standard with the cost of failure being liability for malpractice. While the Realtors have embraced the status of professionalism, they now seek to avoid the consequences of that status.

The Realtor parties argue that holding them to the standards of their profession would somehow disrupt the real estate economy,

spreading uncertainty and loss through the industry. It would do nothing of the sort. People expect professionals they hire to perform with due care. Real estate professionals are no exception to this rule. It is the ruling that the Realtor parties seek (that professionals don't owe special professional duties to their clients; or, at least, that real estate professionals don't) that would sow confusion and disruption in the real estate economy.

IV. CONCLUSION

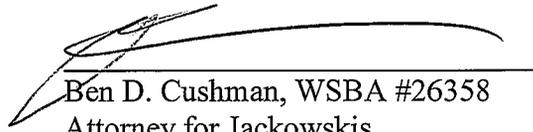
Alejandro v. Bull, 159 Wn.2d 674, 153 P.3d 864 (2007) and Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wn.2d 406, 745 P.2d 1284 (1987) already contain the logic this Court needs to definitively resolve the issues presented in this case. As applied in those cases, the economic loss rule bars a plaintiff from recovering *tort* damages in an *action at law for purely economic losses* when the parties' relationship, rights and duties *arise exclusively from and are governed exclusively by contract*. However, that logic has been misapplied and confused in arguments, and even in decisions, in lower Courts.

This Court should take this opportunity to clarify, as the Texas Courts have done, that the economic loss rule bars tort claims when the claim arises exclusively from and is entirely dependent on the terms of a

contract, but that there are "independent torts" which are not barred by the economic loss rule. Principal among these "independent torts" is the tort of malpractice.

Respectfully submitted this 3rd day of September, 2010.

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CERTIFICATE OF SERVICE

Doreen Milward certifies and declares as follows:

1. I am a paralegal at Cushman Law Offices, P.S. I am over the age of 18, and not a party to this action.
2. On September 3, 2010, I sent via ABC Legal Messengers, for same business day delivery/filing, Jackowskis' Opening Brief to the Supreme Court in Olympia, Washington:
3. On September 3, 2010, I sent via e-mail and via U.S. Mail, first class postage prepaid, a true and correct copy of this same document to the following:

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