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STATE OF WASHINGTON

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Supreme Court No. 836604 RONALD R. CARPENTER
Court of Appeals No. 36944-3-II

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

CLERK

TIMOTHY JACKOWSKI and ERI TAKASI, husband and wife,

Appellants.

v.

DAVID BORCHELT and ROBIN BORCHELT, husband and wife;
HIMLIEREALTY, INC., VINCE HIMLIE, broker for Windermere
Himlie Real estate, real estate brokers, and ROBERT JOHNSON and
JEFF CONKLIN, real estate agents,

Respondents.

SUPPLEMENTAL BRIEF OF RESPONDENTS HIMLIE REALTY, INC.
DBA WINDERMERE REAL ESTATE/HIMLIE AND JEFF CONKLIN

Attorneys for Respondents
Himlie Realty, Inc. and Jeff Conklin

Matthew F. Davis, WSBA No 20939
Melanie Leary, WSBA No. 21050
Demco Law Firm, P.S.
5224 Wilson Ave., Suite 200
Seattle, WA 98118

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I. INTRODUCTION

From Windermere's perspective, this case is not about limiting the duties of real estate brokers. Since this Court's decision in *Hoffman v. Connall*, 108 Wn.2d 69, 77-78, 736 P.2d 242, 246 (1987), real estate brokers have been treated as professionals and held to a professional standard of care. When the legislature codified the duties of real estate agents in RCW Chapter 18.86, it drew on that professional standard to establish a clear set of duties. Real estate brokers are familiar with the standards to which they are held and have adapted to those requirements.

The court of appeals decision in this case eliminates the certainty and clarity that the agency statute created. Making matters worse, that decision effectively creates two sets of rules for tort liability: one for buyers and sellers, and one for brokers. Under the court's decision, brokers are liable, while buyers and sellers are not.

In *DeNike v. Mowery*, 69 Wn.2d 357, 366, 418 P.2d 1010, 1017 (1966), this Court observed that: "Common-sense justice is, of course, the most desirable objective inherent in the application of any legal concept; and where the application of a legal concept so clearly results in injustice, it is incumbent upon the courts to examine the concept and its applicability most carefully." This Court should restore common sense to the law.

II. DISCUSSION

A. Economic Loss Rule

This Court's decision in *Alejandre v. Bull*, 159 Wn.2d 674, 153 P.3d 864 (2007), significantly altered the landscape of tort law in Washington. Under the Court's ruling, the economic loss rule bars tort claims whenever the damages are economic and the parties have a contractual relationship. Although that statement may appear to be hyperbole, it isn't. The Court said: "In short, the purpose of the economic loss rule is to bar recovery for alleged breach of tort duties where a contractual relationship exists and the losses are economic losses." *Id.* at 683.

Most directly, *Alejandre* abrogated the cause of action for negligent misrepresentation. Under *Alejandre*, negligent misrepresentation claims are barred whenever the parties have a contractual relationship and the damages are economic, which, effectively, is all of the time. Washington has long followed the Restatement of Torts elements of negligent misrepresentation:

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

Van Dinter v. Orr, 157 Wn.2d 329, 332, 138 P.3d 608, 609 (2006) (emphasis added). A cause of action for negligent misrepresentation requires a “transaction” or contract, and the damages are limited to pecuniary or economic loss. Restatement (Second) of Torts § 552 (1977).

The very elements necessary to prove the claim also compel dismissal under the economic loss rule. See *Carlile v. Harbour Homes, Inc.*, 147 Wn.App. 193, 203, 194 P.3d 280, 285 (2008) (In *Alejandre*, “our supreme court held that a homebuyer's negligent misrepresentation tort claim against the seller was precluded under the economic loss rule.”). It is all but impossible to imagine any negligent misrepresentation claim that would not be barred by *Alejandre*.

Alejandre is abundantly clear about negligent misrepresentation, but application of the economic loss rule to other claims has proven problematic. This difficulty arises because *Alejandre* indicates that exceptions to the economic loss rule exist, but provides little guidance for lower courts in deciding what exceptions are proper.

The operative sentence in *Alejandre* states: “If the claimed loss is an economic loss, and no exception applies to the economic loss rule, then the parties will be limited to contractual remedies.” *Alejandre*, 159 Wn.2d

at 684. This sentence has generated an ever increasing number of exception claims, which in turn have resulted in seemingly inconsistent appellate decisions.

The *Alejandre* court did recognize an exception to the economic loss rule for fraudulent concealment claims, but its analysis is difficult to follow. The exception for fraudulent concealment claims appears to be based on the fact that in *Atherton Condo. Apartment-Owners Ass'n Bd. of Dirs. v. Blume Dev. Co.*, 115 Wn.2d 506, 799 P.2d 250 (1990), the Court permitted a fraudulent concealment claim to go to trial.

The plaintiffs also assert a claim of fraudulent concealment. In *Atherton*, we rejected the plaintiff's claim of negligent construction as barred by the economic loss rule, but in the same opinion held that there was an issue of fact as to whether the defendant had fraudulently concealed construction practices violating the building code and therefore the trial court had erred in dismissing the plaintiffs' claim for fraudulent concealment on a motion for summary judgment. *Atherton*, 115 Wash.2d at 523-27, 799 P.2d 250. Thus, under *Atherton*, the Alejandres' fraudulent concealment claim is not precluded by the economic loss rule.

Alejandre, 159 Wn.2d at 689. *Atherton*, however, never addressed the economic loss rule in the context of the fraudulent concealment claim, and certainly did not indicate that fraudulent concealment was an exception to the economic loss rule.

If prior acceptance of a claim by the Supreme Court establishes an exception to the economic loss rule, however, then negligent misrepresentation should also be an exception. This Court has expressly recognized a cause of action for negligent misrepresentation under Section 552 of the Restatement of Torts on no less than seven occasions.¹ Both claims were equally well established under Washington law when *Alejandre* was decided, yet negligent misrepresentation claims are barred while fraudulent concealment claims are not.

Perhaps the most compelling question left unanswered by *Alejandre* was the fate of fraud claims. Although a claim for fraud was alleged in *Alejandre*, the Court declined in a footnote to decide whether it was an exception to the economic loss rule. *Alejandre*, 159 Wn.2d at 690 n. 6 (“We need not address the question whether any or all fraudulent representation claims should be foreclosed by the economic loss rule because we resolve the Alejandres’ fraudulent representation claims on other grounds.”).

¹ *Haberman v. Washington Public Power Supply System*, 109 Wn.2d 107, 161, 744 P.2d 1032, 1067 (1987); *Hines v. Data Line Systems, Inc.*, 114 Wn.2d 127, 150, 787 P.2d 8, 21 (1990); *Havens v. C & D Plastics, Inc.*, 124 Wn.2d 158, 180, 876 P.2d 435, 447 (1994); *Schaaf v. Highfield*, 127 Wn.2d 17, 22, 896 P.2d 665, 668 (1995); *ESCA Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 826, 959 P.2d 651, 654 (1998); *Lawyers Title Ins. Corp. v. Baik*, 147 Wn.2d 536, 545, 55 P.3d 619, 623 (2002); *Van Dinter v. Orr*, 157 Wn.2d 329, 332, 138 P.3d 608, 609 (2006).

That question could not remain unanswered for long. In *Carlile*, Division One was forced to reconcile the rule barring negligent misrepresentation claims with the exception for fraudulent concealment claims. *Carlile*, 147 Wn.App. at 203-04. That distinction proved elusive.

Ultimately, the *Carlile* court held that fraud claims are subject to the economic loss rule because of differences in the number or nature of the elements of claims for fraud and fraudulent concealment.

The court in *Alejandre* recognized that fraudulent concealment claims are not precluded by the economic loss rule. But no Washington court has held that a claim for intentional misrepresentation (fraud) falls outside of the economic loss rule. The two tort claims have distinct elements. A claim for fraudulent concealment requires a plaintiff to show:

- (1) [that] the residential dwelling has a concealed defect;
- (2) the vendor has knowledge of the defect;
- (3) the defect presents a danger to the property, health, or life of the purchaser;
- (4) the defect is unknown to the purchaser; and
- (5) the defect would not be disclosed by a careful, reasonable inspection by the purchaser.

Id.

The nine elements of intentional misrepresentation (fraud) are:

- (1) representation of an existing fact;
- (2) materiality;
- (3) falsity;
- (4) the speaker's knowledge of its falsity;
- (5) intent of the speaker that it should be acted upon by the plaintiff;
- (6) plaintiff's ignorance of its falsity;
- (7) plaintiff's reliance on the truth of

the representation; (8) plaintiff's right to rely upon the representation; and (9) damages suffered by the plaintiff.

Given the difference in elements between the two types of claims, there is no reason to conclude that an intentional misrepresentation claim should be treated the same as the fraudulent concealment claim in *Alejandre*. More importantly, there is no reason here to exempt an intentional misrepresentation claim from the general exclusion of tort-based claims under the rationale of the economic loss rule.

Carlile, 147 Wn.App. at 204-205 (footnotes omitted).

While it undoubtedly is true that fraud and fraudulent concealment have different elements, why that difference would affect application of the economic loss rule is unclear. *Atherton* itself described fraudulent concealment as "a species of fraud." *Atherton*, 115 Wn.2d at 523 n.11 (quoting *Liebergessell v. Evans*, 93 Wn.2d 881, 893, 613 P.2d 1170 (1980)). Consequently, an exception to the economic loss rule exists for fraudulent concealment as a species of fraud, but not for fraud itself.

To its credit, the *Carlile* court simply followed the plain language of *Alejandre* to its logical conclusion. Fraud claims usually arise out of contractual relationships and seek economic damages. *Alejandre* plainly bars such tort claims, and no principled distinction can be made between negligent misrepresentation and fraud claims on that basis. If negligent misrepresentation claims are barred, then so, too, should fraud claims.

Perhaps because it was bound by *Alejandre*, the *Carlile* court never addressed the policy implications or wisdom of barring fraud claims.

The court of appeals in this case took an entirely different approach when it held that claims for professional malpractice are not subject to the economic loss rule. Nothing in *Alejandre* suggests an exception for such claims, and no logical distinction can be made on economic loss grounds, but the court was unwilling to hold that malpractice claims are barred.

Neither do we believe that the economic loss rule, as described in *Alejandre*, abrogates all professional malpractice claims, particularly where a client hires a professional and, therefore, establishes a privity of contract with that professional. We distinguish this holding from *Alejandre*, which did not involve a buyer suing his real estate agent, but rather, suing the seller. *Alejandre*, 159 Wash.2d at 680, 153 P.3d 864. We are not willing at this time to expand our Supreme Court's holding in *Alejandre* to preclude all recovery for economic loss against professional agents, as to do so would be to abrogate professional malpractice claims for all cases not involving physical harm. We do not believe this to be the *Alejandre* court's intention.

Jackowski v. Borchelt, 151 Wn.App. at 14. While the *Carlile* court refrained from applying policy considerations, the court of appeals here relied exclusively on them.

The court of appeals decision is certainly understandable. It is hard to imagine that Washington courts would preclude claims for legal

malpractice, but it is equally hard to believe that Washington would abrogate established claims for fraud or negligent misrepresentation. But that is now the law of the land.

This appeal does not directly raise the question whether the Court should reconsider the economic loss rule as announced in *Alejandre*, but it does raise the matter of inconsistent and *ad hoc* exceptions. When the economic loss rule is not applied consistently, the fundamental allocation of responsibility and liability is altered without due consideration. In this case, brokers are liable in tort for economic losses while the parties to the transactions are not, creating an upside down world in which the agent becomes liable for the tort of the principal.

This Court has previously warned of the dangers that result from the creation of arbitrary and inconsistent exceptions to the law.

Judicial approaches should be reexamined when the court creates several technical exceptions to preexisting holdings or when the holdings are differently applied for no significant reason. See *deElche v. Jacobsen*, 95 Wash.2d 237, 247, 622 P.2d 835 (1981); *In re Stranger Creek*, 77 Wash.2d 649, 466 P.2d 508 (1970); *DeNike v. Mowery*, 69 Wash.2d 357, 418 P.2d 1010 (1966). The presence of inconsistent analyses or exceptions suggest the approach may have outlived its relevance or was improvidently fashioned.

Johnson v. Johnson, 96 Wn.2d 255, 264, 634 P.2d 877, 882 (1981)
(examining inconsistent approaches to determining validity of use of

public funds). This Court should reconsider what exceptions to the economic loss rule will be recognized, and should establish fair and consistent rules for their application.

B. RCW Chapter 18.86.

Since the court of appeals decision in this case, Division One concurred with the ruling that “a real estate agent ‘retains common law duties’ owed to clients. “*Boguch v. Landover Corp.* 153 Wn.App. 595, ___, 224 P.3d 795, 802 (2009) (quoting *Jackowski*, 151 Wn.App. at 14). This misinterpretation of RCW Chapter 18.86 threatens to undermine the legislature’s purpose in enacting the agency statute.

The legislature’s intent to define rather than supplement the duties of real estate brokers is evident from the language of the statute and the legislative history. A statutory mandate that brokers’ duties are “limited to” those set forth in the statute could not be more clear. RCW 18.86.040(1); RCW 18.86.050(1); RCW 18.86.060(2).

Application of common law duties also renders other portions of the agency statute superfluous or impossible. For example, the agency statute requires brokers to provide clients with a pamphlet that describes the duties of agents and brokers. RCW 18.86.030(1)(f). The mandatory contents of that pamphlet describe the agency statute as a complete list of a broker’s duties. RCW 18.86.120.

Similarly, RCW 18.86.020 defines how brokers form agency relationships, and RCW 18.86.070 defines how those agency relationships can be terminated. If the parties were still subject to the common law, then common law agency relationships could be formed and terminated under common law rather than statutory rules. Brokers might have a common, but not statutory, agency relationship.

The agency statute largely abrogates imputed knowledge and vicarious liability arising out of agency relationships created under the statute or by written agreement. RCW 18.86.090 (vicarious liability); 18.86.100 (imputed knowledge); 18.86.010(1) (definition of “agency relationship”). If the common law continues to apply, the oral or implied agency relationships would still be subject to vicarious liability and imputed knowledge.

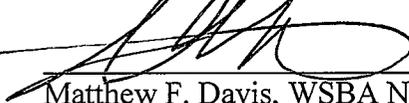
In summary, the court’s holding that the common law continues to apply turns a statute designed to bring clarity to brokerage relationships into a multilayered quagmire. This Court should reverse the court of appeals and hold that the agency statute redefines agency law for real estate brokers and, therefore, necessarily supersedes the common law.

III. CONCLUSION

The law should be a level playing field, with the same rules for all. Under the court of appeals decision in this case, brokers (and other professionals) are unfairly singled out and subject to tort liability. This Court should establish uniform rules for application of the economic loss rule and should enforce the legislative intent to codify the agency duties of real estate brokers.

DATED this 24th day of March, 2010.

DEMCO LAW FIRM, P.S.



Matthew F. Davis, WSBA No. 20939
Melanie A. Leary, WSBA No. 21050
Attorneys for Windermere Respondents
DEMCO LAW FIRM, P.S.
5224 Wilson Avenue South, Suite 200
Seattle, WA 98118
(206) 203-6000

DECLARATION OF SERVICE

I, Leslie Rothbaum, state:

On this day I caused to be served by e-mail to the following:

Jon Cushman
Cushman Law Offices, P.S.
924 Capital Way South
Olympia, WA 98501

Robert W. Johnson
Robert W. Johnson P.L.L.C.
Angle Building
P.O. Box 1400
Shelton, WA 98584

Jeffrey Downer
Lee Smart P.S., Inc. 1800 One
Convention Place
701 Pike Street
Seattle, WA 98101-3929

K. Michael Fandel
David M Byers
Daniel J. Oates
Graham & Dunn, PC
2801 Alaskan Way, Ste. 300
Seattle, WA 98121-1128

and delivered by ABC messenger to:

Court of Appeals, Division II
950 Broadway #300
M/S TB-06
Tacoma, WA 98402-4427

A copy of the following documents:

APPELLANTS' SUPPLEMENTAL BRIEFING

Declarant is a resident of the State of Washington and over the age of eighteen (18) years. I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Dated this 24 day of March, 2010 at Seattle, Washington.

Leslie Rothbaum
Leslie Rothbaum