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COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

IN THE COURT OF APPEALS
STATE OF WASHINGTON
DIVISION III

TIMOTHY WEIDERT, individually and L.W. WEIDERT FARMS, INC.,
a Washington corporation,

Respondent

v.

JERALD A. HANSON dba WALLA WALLA INSURANCE SERVICES
AND JERALD AND JANE DOE HANSON,
Defendants.

AND PRODUCERS AGRICULTURE INSURANCE COMPANY
Petitioner.

BRIEF OF APPELLANT

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I. INTRODUCTION

Producers Agriculture seeks to compel arbitration in a dispute arising under a federal crop insurance policy. The arbitration provision at issue is unique because it is both contractual provision and federal regulation. Tim Weidert and L.W. Weidert Farms assert that the Washington law equitable principals override the arbitration agreement because enforcement of the agreement would result in an “empty chair” defendant at trial. However, Washington law is pre-empted and arbitration of this dispute is mandated under Federal Crop Insurance Act, 7 U.S.C. § 1501 and the Federal Arbitration Act, 9 U.S.C. § 2.

II. ASSIGNMENTS OF ERROR

1. The trial court erred when it used its equitable power to override a valid arbitration provision.
2. The trial court erred when it failed to find that the Federal Crop Insurance Act, 7 U.S.C. § 1501, and accompanying regulations pre-empt Washington law
3. The trial court erred when it failed to find that the Federal Arbitration Act, 9 U.S.C. § 2, pre-empts Washington law.

III. STATEMENT OF THE CASE

Tim Weidert and L.W. Weidert Farms (“the Weiderts”) purchased a Multi-Peril Crop Insurance Policy (MPCI Policy) for the 2009 crop

year. CP 2, ¶3.1.. The policies were sold through a private insurance agent, Jerald Hanson d/b/a/ Walla Walla Insurance Services. *Id.* The policies were issued by Producers Agriculture Insurance (“ProAg”), a private insurer, and reinsured by the Federal Crop Insurance Corporation as part of a government program established by the Federal Crop Insurance Act (FCIA). CP 2, ¶ 3.1. Federal law defines and governs the sale, issuance, and service terms of the policies. *Nobles v. Rural Cmty. Ins. Servs.*, 122 F. Supp. 2d 1290, 1295 (M.D. Ala. 2000).

In general, an MPCCI Policy provides a form of catastrophic insurance protecting farmers from losses resulting from specified perils. The insurance guarantees that the farmer will have the equivalent of a crop production at a specified level per acre. *Meyer v. Nat’l Farmers Union Prop. & Cas. Co.*, 957 F. Supp. 1492, 1494 (D. Wyo. 1997). The dispute in this case stems from an adjustment¹ of the insured yield and a reduction in the amount of coverage for the Weiderts’ crops. CP 3, ¶3.8.

The policy contains a dispute resolution clause that provides, in pertinent part:

20. Mediation, Arbitration, Appeal, Reconsideration, and Administrative and Judicial Review.

¹ The Common Crop Insurance Regulations provides that “approved yield[s] will be adjusted” for a variety of reasons. 7 C.F.R. § 457.8. ¶ 3.

(a) If you and we fail to agree on **any determination** made by us except those specified in section 20(d) or (e),² the disagreement may be resolved through mediation in accordance with section 20(g). If resolution cannot be reached through mediation, or you and we do not agree to mediation, the disagreement must be resolved through arbitration in accordance with the rules of the American Arbitration Association (AAA) except as provided in sections 20(c) and (f) . . .

(2) If you fail to initiate arbitration in accordance with section 20(b)(1) **and complete the process**, you will not be able to resolve the dispute through judicial review.

Basic Provisions, 7 C.F.R. § 457.8, ¶ 20 (emphasis added).

The Weiderts filed a crop loss claim for the 2009 crop. CP 4, ¶ 3.10 . They received “approximately \$522,306.00”. *Id.* The Weiderts assert they are entitled to additional coverage under the terms of the policy. CP 3, ¶ 3.7. Pursuant to the terms of the MPCCI Policy, the Wiederts initiated arbitration. CP 119. At the same time, Timothy Weidert and L.W. Weidert Farms, Inc. brought a civil suit against the insurance agent, Jerald Hason. CP 1.

² Subsection (d) applies to determinations relating to “good farming practices.” This is not an issue in the underlying litigation.

The parties agreed to hold the arbitration in abeyance until resolution of the suit against Mr. Hanson. CP 117. But instead, on April 25, 2011, Mr. Weidert and L.W. Weidert Farms joined ProAg as a co-defendant in the civil litigation. CP 1-6. ProAg moved to stay the court proceedings and compel arbitration under the terms of the MPCCI Policy and the Federal Arbitration Act. CP 7-19. The trial court found that “its equitable powers allow the Court to override any arbitration requirement, under the unique facts of this case.” CP 213-216.

IV. ARGUMENT

A. **The Court of Appeals reviews a decision denying arbitration de novo.**

The Court of Appeals reviews a trial court’s decision to deny arbitration de novo. *Walters v. A.A.A. Waterproofing, Inc.*, 151 Wn. App. 316, 320, 211 P.3d 454 (2009) (citing *Adler v. Fred Lind Manor*, 153 Wn.2d 331, 342, 103 P.3d 773 (2004)). Where the underlying facts are not in dispute, the issue of whether arbitration is proper can be decided as a matter of law. *Walters*, 151 Wn. App. at 320. The Weiderts, as the parties challenging the enforceability of the arbitration clause, “bear[] the burden of proving that the claims at issue are unsuitable for arbitration.” *Green Tree Fin. Corp.-Ala. v. Randolph*, 531 U.S. 79, 91, 121 S. Ct. 513, 148 L. Ed. 2d 373 (2000); *Zuver v. Airtouch Commc’ns, Inc.*, 153 Wn.2d 293, 302, 103 P.3d 753 (2004)(citations omitted).

B. The Issue of Arbitrability is Governed by Federal Law.

The arbitration provision at issue here is unique because it is both contractual provision and federal regulation. The Weiderts assert that the issue of arbitrability is governed solely by state law. CP 123-126.

However, the issue is governed exclusively by federal law because, as explained herein, the FCIA and attendant regulations preempt inconsistent state law. The crop insurance policy at issue is part of a federal program; its very terms are federal regulations. In addition, the present dispute arises under the ambit of the Federal Arbitration Act (FAA), and the FAA's savings clause provides for the application of state law only in very limited circumstances. 9 U.S.C. § 2. Recent rulings by the United States Supreme Court and the Court of Appeals for the Ninth Circuit have further clarified the limited scope of the savings clause under the FAA. *See AT & T Mobility LLC v. Concepcion*, 563 U.S. —, 131 S.Ct. 1740, 1747, 179 L.Ed.2d 742 (2011); *Kilgore v. KeyBank, Nat'l Ass'n*, ___ F.3d ___, 2012 WL 718344 (9th Cir. Mar. 7, 2012). Federal law requires that the MPCCI policy's arbitration clause be enforced.

1. The Federal MPCCI Policy Mandates Arbitration.

Congress enacted the FCIA, 7 U.S.C. § 1501, *et seq.*, "to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance and providing the means for the

research and experience helpful in devising and establishing such insurance.” 7 U.S.C. § 1502(a). The Act established the Federal Crop Insurance Corporation (“FCIC”) as an agency of and within the United States Department of Agriculture (“USDA”), 7 U.S.C. § 1503, to administer and regulate a comprehensive all-risk federal crop insurance program. 7 U.S.C. §§ 1503, 1507(c)(2). The Act authorizes the FCIC to:

insure, or provide reinsurance for insurers of, producers of agricultural commodities grown in the United States, under 1 or more plans of insurance determined by the [FCIC] to be adapted to the agricultural commodity concerned. *To qualify for coverage under a plan of insurance, the losses of the insured commodity must be due to drought, flood or other natural disaster*

7 U.S.C. § 1508(a)(1) (emphasis added).

In 1979, Congress expanded the Federal crop insurance program and, for the first time, authorized FCIC "to use private companies in administering the program." S. Rep. No. 254, 96th Cong., 1st Sess. 7, 10 (1979). In addition, Congress took several steps to ensure increased farmer participation. For example, Congress lifted restrictions on the availability of federal crop insurance and expanded the program to "all counties and all crops." *Id.* at 7 (1979). Congress also provided for federal cost-sharing by directing the FCIC to subsidize a farmer's premium costs. *See* 7 U.S.C. §1508(e). In addition, to encourage private

delivery by private insurance providers, Congress authorized FCIC to reinsure the indemnities paid to producers, *id.* at § 1508(k)(1), and to subsidize the AIPs' delivery costs through the payment of an Administrative and Operating Subsidy, 7 U.S.C. § 1508(k)(4). As a condition of reinsurance and the A&O Subsidy, AIPs must "follow all applicable Corporation procedures in [their] administration of the crop insurance policies reinsured." 7 C.F.R. § 400.168(a). Licensed private insurance agents sell policies issued by the FCIC and are compensated from the premiums paid by the private insurance providers. 7 U.S.C. § 1507(c)(3). The FCIC provides reinsurance to insurers which sell crop insurance policies issued in the insurer's name. 7 U.S.C. § 1507(c); § 1508.

Notwithstanding the private delivery mechanism, FCIC controls all aspects of the federal crop insurance program. To this end, FCIC establishes the regulatory framework and the Risk Management Agency ("RMA")³ issues the policies and procedures applicable to the crop insurance program. An MPCCI Policy consists of three separate insurance documents, which form a pyramid of coverage terms, criteria and

³RMA supervises FCIC and has authority over the delivery of all programs authorized by the Act. 7 U.S.C. § 6933(b). Although legally distinct agencies, RMA and FCIC operate as one entity. The terms "FCIC" and "RMA" may be used interchangeably throughout the remainder of this brief.

exclusions. The foundation document is the Common Crop Insurance Policy (“Basic Provisions”). The Basic Provisions establish the general terms and conditions that are applicable to substantially all crops insured through the Federal crop insurance program. The Basic Provisions are a federal regulation published at 7 C.F.R. § 457.8. The second level of the policy pyramid is the “Crop Provisions.” The Crop Provisions more narrowly focus the scope of coverage by providing the insuring conditions on a crop-by-crop basis. Like the Basic Provisions, the various Crop Provisions are federal regulations. *See* 7 C.F.R. §§ 457.101-173. The third component of the MPCCI Policy is the Special Provisions of Insurance (“SPOI”). The SPOI provide additional terms, conditions and exclusions relative to a particular crop on a county-by-county basis.

The Basic Provisions includes a provision stating that it is "reinsured by the [FCIC] under the provisions of the Act," and that "all provisions of the policy and rights and responsibilities of the parties are specifically subject to the Act." 7 C.F.R. § 457.8 (Preamble). Accordingly, each of the terms of a federally-reinsured crop insurance policy is a matter of substantive federal law. The Preamble further states that the insurance company “will use the procedures (handbooks, manuals, memoranda and bulletins), as issued by FCIC and published on RMA’s Web site . . . in the administration of this policy.” In addition, the

Preamble states that the policy provisions “may not be waived or varied in any way” by the crop insurance agent or any other agent or employee of FCIC or the company. *Id.* Furthermore Crop insurance regulations are binding on those who claim benefits under a federal crop insurance policy without regard to their actual knowledge of the content of the regulations. *Federal Crop Ins. Corp. v. Merrill*, 332 U.S. 380, 68 S. Ct. 1, 92 L. Ed. 10, 175 A.L.R. 1075 (1947).

To effectuate the purposes of the Act, Congress gave the FCIC broad powers, including all “such powers as may be necessary or appropriate for the exercise of the powers [therein] specifically conferred upon the Corporation and all such incidental powers as are customary in corporations generally.” 7 U.S.C. §1506(k). In addition, To ensure that “all claims for losses are adjusted . . . in a uniform and timely manner,” 7 U.S.C. § 1508(j)(1), Congress specifically provided for the preemption of state regulation of the federal crop insurance program:

State and local laws or rules shall not apply to contracts, agreements, or regulations of the Corporation or the parties thereto to the extent that such contracts, agreements, or regulations provide that such laws or rules shall not apply, or to the extent that such laws or rules are inconsistent with such contracts, agreements, or regulations.

7 U.S.C. § 1506(1). In addition to preempting state laws “inconsistent” with FCIA or the FCIC’s regulations, or agreements, the

FCIC is also authorized “to issue regulations and contracts that generally preempt the application of state law to the crop insurance industry.”

55 Fed. Reg. 20366, 23068 (1990).

By the early 1990s, Congress’ objective of ensuring a uniform system of federal crop insurance faced a serious threat. Notwithstanding that express preemption of state law, many states began to interfere with the FCIC’s administration and regulation of the program. The FCIC encountered “frequent occurrences” of “State agencies requiring change in federally approved insurance policies to the extent that neighboring policyholders receive[d] differing levels of federal assistance depending on whether they obtain[ed] their policy from FCIC or from a reinsured company, or depending on whether they live[d] in differing States.” *Id.* at 23066. In response to encroaching state regulation and pursuant to its congressionally delegated authority under 7 U.S.C. § 1506(1), the FCIC promulgated a regulation clarifying the FCIA’s broad preemption of state law:

No State or local governmental body or non-governmental body shall have the authority to promulgate rules or regulations, pass laws, or issue policies or decisions **that directly or indirectly affect or govern agreements, contracts, or actions authorized by this part** unless such authority is specifically authorized by this part or by the Corporation.

7 C.F.R. § 400.352(a) (emphasis added).

As the FCIC explained in its rulemaking, “[t]he procedures, rules, and terms of [federal crop] insurance are to be established by FCIC.” 55 Fed. Reg. 23067. As the agency emphasized, the terms and conditions of federal crop insurance “cannot be enforced in a patchwork pattern.” *Id.* Rather, federal law must control “not only the contractual relationship with its contractors,” but also “the relationship such contractors have with insureds.” *Id.* at 23068. Otherwise, the FCIC would not be able “to carry out its Congressional mandate to establish crop insurance uniformly throughout the United States.” *Id.* at 23067-68. Hence, the determination of liability with respect to the sale, issuance, or service of a federal crop insurance policy is governed exclusively by the FCIA and the established rules, regulations, policies, and procedures of the FCIC.

The U.S. Department of Agriculture’s Risk Management (“RMA”) on behalf of FCIC provides final agency, provides final agency determinations (“FADs”) interpreting the FCIA and regulations promulgated under FCIA. These determinations are final and binding on all participants in the crop insurance program. 7 C.F.R. § 400.765. Because the MPCCI Policy is a federal regulation, FADs are the only

mechanism by which program participants may obtain interpretations of the insurance policy.

In Final Agency Determination: FAD-013, RMA explained that arbitration is a condition precedent to litigation, stating: “**Arbitration must be completed prior to the producer’s bringing any suit in a court.**”⁴ An agency’s interpretation of its own regulation is entitled to “substantial deference . . . unless it is plainly erroneous or inconsistent with the regulation.” *Sigma Tau Pharms, Inc. v. Schwetz*, 288 F.3d 141, 146 (4th Cir. 2002)(citations omitted). Moreover, deference is especially appropriate if “the regulation concerns a complex highly technical regulatory program, in which the identification and classification of relevant criteria necessarily require significant expertise and entail the exercise of judgment grounded in policy concerns.” *Thomas Jefferson Univ. v. Shalala*, 512 U.S. 504, 512, 114 S. Ct. 2381, 129 L. Ed. 2d 405 (1994) (citations omitted). Because RMA’s interpretation of the insurance policies necessitated subject-specific expertise and arose in the context of a broad regulatory scheme, FAD-013 is entitled to substantial deference. As the Supreme Court has stated, “the terms and conditions’ upon which

⁴FAD-013 interprets section 25 of the insurance policy in effect prior to 2005. Nonetheless, FAD-013 manifest RMA’s intent for producers to arbitrate disputes prior to commencing litigation in court.

valid governmental insurance can be had must be defined by the agency acting for the Government.” See *Merrill*, 332 U.S. at 383. See also *Flick v. Liberty Mut. Fire Ins. Co.*, 205 F.3d 386, 390 (9th Cir. 2000) citing *Merrill* (federal law mandates that strict compliance with terms of a federal insurance policy).

In considering ProAg’s motion to compel arbitration, the trial ignored the preemption of Washington law by the FCIA, FCIC’s regulations, the FCIC’s interpretation of those regulations and the Basic Provisions and did not enforce the terms of the Basic Provisions compelling the arbitration of all disputed determinations made by a private insurer.

2. Courts Enforce the MPCCI Policy’s Arbitration Clause.

Both state and federal courts have consistently enforced the MPCCI policy’s arbitration clause notwithstanding the existence of contrary or inconsistent state law.

In *IGF Ins. Co. v. Hat Creek P’ship*, 349 Ark. 133, 76 S.W.3d 859 (Ark. 2002), the Arkansas Supreme Court recognized that the FCIC rule mandating arbitration clauses in federal crop insurance policies (7 C.F.R. § 457.8) superseded provisions of the Arkansas Arbitration Act that would otherwise have rendered the arbitration clause unenforceable. *Hat Creek*,

76 S.W.3d at 866. The district court in *Hoelt v. Rain & Hail, LLC*, 2001 WL 34039497 (D. Ore. Oct. 31, 2001), similarly held that the federal crop insurance policy's arbitration provision preempted an Oregon statute which provided that arbitration provisions in insurance contracts were not enforceable. *Id.* at *4. The court noted that the Supremacy Clause of the United States Constitution (Art. VI, c1.2) invalidates state laws that interfere with, or are in contrast to, federal law. *Id.* (citing *Hillsborough County v. Automated Med. Labs., Inc.*, 471 U.S. 707, 712, 105 S. Ct. 2371, 85 L. Ed. 2d 714 (1985)).

Also, in *Continental Casualty Company v. McCall*, Cause No. 97,797 (Okla. July 1, 2002), a mandamus proceeding, the Oklahoma Supreme Court recognized that both "7 U.S.C. § 1506(1) and C.F.R. § 400.352 specifically provide that state and local laws shall not apply to crop insurance contracts to the extent that such laws or rules are inconsistent with the insurance policies." The Oklahoma court noted that 15 O.S. § 818, which precludes enforcement under the Oklahoma Uniform Arbitration Act of arbitration clauses contained in insurance contracts, is inconsistent with the MPCCI arbitration provision. The court found that 15 O.S. § 818 was preempted and, thus, ordered enforcement of the arbitration provision in accordance with the FAA.

The Southern District of New York in *Ledford Farms, Inc. v. Fireman's Fund Ins. Co.*, 184 F. Supp. 2d 1242 (S.D. Fla. 2001), granted a motion to compel arbitration, rejecting the plaintiff's assertion that the decision by the reinsured company to deny indemnity based upon a policy exclusion was not a factual determination. The court noted:

Ledford asserts that the MPCCI policy does not define "practical to replant" and, thus, this "vague and ambiguous" exclusionary term cannot be construed against coverage. Ledford's argument is unavailing for at least two reasons. First, ... the policy does, in fact, define "practical to replant." Second, Ledford's argument is an apparent attempt to convert Fireman's Fund's factual determination—that it was practical for Ledford to replant its bean crop—into a legal determination which would fall outside the scope of the arbitration clause. The fact that the arbitrator must read and interpret the policy definition of "practical to replant" does not transform the determination of Fireman's Fund into a legal determination.

Id. at 1245. See also *Crook v. Fireman's Fund AgriBusiness, Inc.*, 2000 WL 33650721 (W.D. La. Sept. 5, 2000) (granting motion to compel arbitration under crop insurance policy). As the court stated in *Nobles v. Rural Cmty. Ins. Servs.*, 122 F. Supp. 2d 1290, 1295 (M.D. Ala. 2000) :

Plaintiffs must submit [the dispute] to binding arbitration . . . [A]fter that dispute is resolved, and in keeping with the arbitrator's findings and awards that are

entitled to preclusive effect, Plaintiffs may then elect to pursue their claims [in court].

Id. at 1293.

Finally, in *In re 2000 Sugar Beet Crop Insurance Litigation*, the Minnesota federal district court expressly held that the federal crop insurance policy's arbitration provision is exempt from the reverse preemption⁵ of the McCarran-Ferguson Act. 228 F.Supp.2d 992, 996 (D. Minn. 2002). That case involved a Minnesota statute which precluded enforcement of arbitration provisions in insurance contracts. *Id.* Finding federal law to be controlling, the court held:

The court finds it most unlikely that when Congress created federal crop insurance, specifically intending to provide a uniform and accessible system of farmer protection, it also intended to allow fifty states to administer that program according to fifty different state insurance regulatory schemes. Because Congressional statutes specifically relating to the business of insurance supersede state law, the FAA and other federal laws are applicable. The FCIC is to be construed according to the FAA and federal law, not Minnesota law or any other state law.

Id. at 997.

⁵ Reverse preemption is so named because the federal law is actually being preempted by state law. This occurs because the McCarran-Ferguson Act specifically gives power to the states with regard to the business of insurance.

Therefore, any suggestion by the Weiderts that Washington law prohibits enforcement of the arbitration provision is without merit. Federal law mandates that state law cannot vary the provisions of the federal crop insurance policy, which includes a clear directive that disputes regarding any determinations made by ProAg are to be arbitrated. Any provision of Washington law which does not allow for arbitration herein is preempted and unenforceable.

3. The Federal Arbitration Act Mandates Arbitration.

a. The Federal Arbitration Act Applies to the Weidert's Policy.

The enforcement of the arbitration clause in a federal crop insurance policy is also mandated by the Federal Arbitration Act (“FAA”) 9 U.S.C. § 1 et seq. The FAA establishes a “federal policy favoring arbitration.” *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25, 111 S. Ct. 1647, 1651, 114 L. Ed. 2d 26 (1991) (noting that the FAA manifests a liberal federal policy favoring arbitration agreements). “State and federal courts must enforce the Federal Arbitration Act (FAA), 9 U.S.C. § 1 et seq., with respect to all arbitration agreements covered by that statute.” *Marmet Health Care Ctr., Inc. v. Brown*, ___ U.S. ___, 132 S. Ct. 1201, 1202 (2012).

The FAA, provides, in pertinent part, that:

[a] written provision . . . in a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or equity for the revocation of any contract.

9 U.S.C. § 2. Thus, the FAA requires enforcement of an arbitration agreement upon proof: (1) that a written agreement to arbitrate exists and (2) that the written agreement is contained within a contract evidencing a transaction involving “commerce.” *Id.*

The arbitration provision at issue here is contained in a written agreement to arbitrate. The Weiderts acknowledged the agreement to arbitrate by invoking arbitration prior to naming ProAg as a defendant in a lawsuit. CP 119.

The FAA applies to all transactions that “in fact” involve interstate commerce. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281, 115 S.Ct. 834, 130 L. Ed. 2d 753 (1995). Thus, rather than examining whether the parties’ believed they were engaged in interstate activity, a court considering whether there is a contract involving interstate commerce simply looks to whether the transaction involved interstate commerce “in fact.” *Id.* Any doubt concerning the scope of the issues covered by the arbitration agreement should be resolved in favor of

arbitration. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25, 103 S. Ct. 927, 74 L. Ed. 2d 765 (1983).

The insurance contracts at issue here involve interstate commerce in fact. As noted in the Complaint, Plaintiffs, who are citizens of Washington, applied for federal crop insurance policies that were administered by ProAg, which is a foreign insurance corporation, incorporated in the State of Florida. CP 2, ¶ 1.5. Additionally, the policies were reinsured by the FCIC, a governmental corporation of the USDA in Washington, D.C. The FAA applies to the arbitration provisions at issue here.

b. The Federal Arbitration Act Preempts State Law.

In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995), the United States Supreme Court explained:

[T]he FAA not only declared a national policy favoring arbitration, but actually withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.

Id. at 1215-16 (citations omitted). “[T]he basic purpose of the Federal Arbitration Act is to overcome courts’ refusals to enforce agreements to arbitrate.” *Allied-Bruce*, 513 U.S. at 270. The United

States Supreme Court has interpreted the FAA expansively, decreeing that it is to reach all transactions or contracts that fall within the broad scope of Congressional powers relating to interstate commerce. *Id.*, at 273. The FAA “leaves no place for the exercise of discretion by [the] court, but instead mandates that. . . courts **shall direct** the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed.” *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985) (emphasis in original). The litigation must be stayed while the parties proceed to arbitration. 9 U.S.C. § 3.

“The court's role under the Act is therefore limited to determining (1) whether a valid agreement to arbitrate exists and, if it does, (2) whether the agreement encompasses the dispute at issue. If the response is affirmative on both counts, then the Act requires the court to enforce the arbitration agreement in accordance with its terms.” *Chiron Corp. v. Ortho Diagnostic Sys., Inc.*, 207 F.3d 1126, 1130 (9th Cir. 2000) (internal citation omitted).

c. The Agreement Encompasses the Dispute at Issue.

The arbitration clause at issue is very broad. The arbitration clause states that arbitration is required if the parties “fail to agree on **any** determination made by us.” 7 C.F.R. § 457.8, ¶ 20. The term

“determination” at one point was limited to only factual determinations, but The FCIC amended the arbitration requirement in the Basic Provisions in 2004, to include all “determinations” made by a reinsured company. *See General Administrative Regulations, Catastrophic Risk Protection Endorsement, Group Risk Plain of Insurance Regulations for the 2004 and Succeeding Crop Years; and the Common Crop Insurance Regulations, Basic Provisions*, 69 Fed. Reg. 48652, 48714 (Aug. 10, 2004). The term “any determination” necessarily encompasses all of the issues raised by the Weiderts in their complaint. See CP 1-6.

d. Arbitrations Agreements Under the Federal Arbitration Act are Invalidated on State Law Ground in Only Limited Circumstances Not Present Here.

The savings clause of the FAA allows arbitration agreements to be invalidated “only upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. §2. Unless the savings clause applies, arbitration agreements are “valid, irrevocable, and enforceable.” *Id.* State courts have struggled with the application of the savings clause, and the United States Supreme Court has recently issued decisions clarifying its scope. *See Kilgore v. KeyBank, Nat’l Ass’n*, ___ F.3d ___, 2012 WL 718344, *5-6 (9th Cir. Mar. 7, 2012); *AT&T Mobility LLC v. Concepcion*, — U.S. —, 131 S. Ct. 1740, 179 L. Ed. 2d 742 (2011);

Marmet Health Care Ctr., Inc. v. Brown, ___ U.S. ___, 132 S. Ct. 1201 (2012).

The “principal purpose” of the FAA is to “ensur[e] that private arbitration agreements are enforced according to their terms.” *Concepcion*, 131 S. Ct. at 1749, (citations and internal quotations omitted). The savings clause allows arbitration agreements to be invalidated by “generally applicable contract defenses such as fraud, duress, or unconscionability.” *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686-87, 116 S. Ct. 1652, 1655, 134 L. Ed. 2d 902 (1996). However, the U.S. Supreme Court has limited the state courts’ use of unconscionability as a means to prevent enforcement of arbitration agreements. For example, state courts cannot “rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.” *Perry v. Thomas*, 482 U.S. 483, 493 n.9, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987). Defenses that “apply only to arbitration or derive their meaning from the fact that an agreement to arbitrate is at issue” are likewise unenforceable. *Concepcion*, 131 S. Ct. at 1746 (quoting *Casarotto*, 517 U.S. at 687). Furthermore, if the state court determines that a contract is fair enough to enforce all its basic terms, such as price, then the arbitration provision must also be enforced.

Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 281, 115 S. Ct. 834, 130 L. Ed. 2d. 753 (1995).

In *AT&T Mobility LLC v. Concepcion*, — U.S. —, 131 S. Ct. 1740, 1749, 179 L. Ed. 2d 742 (2011), the Court recently clarified the limitations on the unconscionability defense. In *Concepcion*, the Court there addressed the validity of a rule articulated by the California Supreme Court in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P.3d 1100, 30 Cal. Rptr. 3d 76 (2005) (“*Discover Bank*”). In *Discover Bank*, the California Supreme Court held that an arbitration agreement in a consumer contract that contains a class-action waiver is, as a general matter, unconscionable. This became known as the “*Discover Bank rule*.”

The plaintiffs in *Concepcion* were AT&T customers who obtained “free” phones from AT&T, but were then charged \$30.22. in sales tax. *Id.* at 1744. The plaintiffs argued among other things that AT&T had engaged in false advertising. *Id.* The contract provided for “arbitration of all disputes between the parties” and further required that claims be brought in the parties’ “individual capacity, and not as a plaintiff or class member in any purported class or representative proceeding.” The California court and later the Ninth Circuit found the provision was “unconscionable” under California’s *Discover Bank* rule.

The Supreme Court did not agree. The Court found that the *Discover Bank* rule was preempted because “[r]equiring the availability of classwide arbitration interferes with fundamental attributes of arbitration and thus creates a scheme inconsistent with the FAA.” *Concepcion*, 131 S. Ct. at 1748.

The Court found that the FAA preempts state laws in two ways. First, if a state rule or law “prohibits outright the arbitration of a particular kind of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA.” *Id.* at 1747. See also *Marmet Health Care Center, Inc. v. Brown*, ___ U.S. ___, 132 S.Ct. 1201 (2012).

The second way a state law may be preempted is less straightforward. “[W]hen a doctrine normally thought to be generally applicable, such as . . . unconscionability, is alleged to have been applied in a fashion that disfavors arbitration.” *Id.* If the rule is applied in a fashion that disfavors arbitration, then the court must determine if the state law or rule “stand[s] as an obstacle to the accomplishment of the FAA’s objectives,” namely, to “ensure that private arbitration agreements are enforced according to their terms. *Concepcion*, 131 S. Ct. at 1748.

**i. The Trial Court's Ruling
Disfavors Arbitration.**

The Weiderts assert that arbitration in this matter will result in two separate actions and that public policy and judicial economy will be served if all of their claims can be heard in one action. CP 124-126. In *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 84 L. Ed. 2d 158 (1985), the Supreme Court rejected just such an argument. In *Dean Witter*, the Court noted that there were a number of circuits (including the Ninth Circuit) who relied upon the “doctrine of intertwining.” “Intertwining” is “[w]hen arbitrable and nonarbitrable claims arise out of the same transaction, and are sufficiently intertwined factually and legally.” *Id.* at 216. Under the doctrine, a court in its discretion could deny arbitration as to the arbitrable claims and try all the claims together in a single court proceeding. *Id.* at 216-17. The Court noted that “[i]n contrast, the Sixth, Seventh, and Eighth Circuits have held that the Arbitration Act divests the district courts of any discretion regarding arbitration in cases containing both arbitrable and nonarbitrable claims, and instead requires that the courts compel arbitration of arbitrable claims, when asked to do so.” *Id.* at 217. The Sixth, Seventh and Eighth Circuits concluded that “the Act, both through its plain meaning and the strong federal policy it reflects, requires courts to enforce the bargain of

the parties to arbitrate, and ‘not substitute [its] own views of economy and efficiency’ for those of Congress.” *Id.* at 217 (citing *Dickinson v. Heinold Sec., Inc.*, 661 F.2d 638, 646 (7th Cir. 1981)).

The Supreme Court found that the minority approach was correct. It held that courts must rigorously enforce agreements to arbitrate under the FAA, even if doing so means piecemeal litigation. 470 U.S. at 218-21. *Accord, KPMG LLP v. Cocchi*, — U.S. —, 132 S. Ct. 23, 181 L. Ed. 2d 323 (Nov. 7, 2011) (*per curiam*). The Weiderts’ argument that an arbitration provision must yield due to the possibility of piecemeal litigation has already been rejected by the United States Supreme Court as disfavoring arbitration. And even absent Supreme Court precedent, as a practical matter, a broad “no-empty chair” rule would be inconsistent with the FAA. A plaintiff would need only to name a third party defendant, (a party who was not bound by the arbitration agreement) to invalidate the arbitration agreement. A rule which would allow a party to so easily sidestep an arbitration requirement would undermine the well-established policy favoring arbitration. Accordingly, the trial court’s ruling is pre-empted by the FAA.

ii. **Even if the Trial Court’s Ruling is Consistent with the Federal Policy Favoring Arbitration, the Arbitration Provision Is Not Unconscionable Under State Law.**

Parties to a contract are bound by its terms. *See Nat’l Bank of Wash. v. Equity Investors, L.P.*, 81 Wn.2d 886, 912–13, 506 P.2d 20 (1973).). Nonetheless, unconscionability may invalidate an arbitration agreement. *McKee v. AT&T Corp.*, 164 Wn.2d 372, 383, 191 P.3d 845 (2008). But “[c]ourts must indulge every presumption ‘in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.’” *Adler v. Fred Lind Manor*, 153 Wn.2d 331, 342, 103 P.3d 773 (2004) (citing *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25, 103 S. Ct. 927, 74 L. Ed. 2d. 765 (1983)).

Washington courts recognize two kinds of unconscionability: substantive and procedural. *Tjart v. Smith Barney, Inc.*, 107 Wn. App. 885, 898, 28 P.3d 823 (2001). “Substantive unconscionability involves those cases where a clause or term in the contract is alleged to be one-sided or overly harsh, while procedural unconscionability relates to impropriety during the process of forming a contract.” *State v. Brown*, 92 Wn. App. 586, 601, 965 P.2d 1102 (1998). Neither the Weiderts nor the trial court identified what kind of unconscionability prevents

enforcement of the arbitration clause. However, the Weiderts did not assert any objections to the formation of the contract. See CP 2-6. Therefore, it is assumed their claim is that the arbitration clause is substantively unconscionable.

A contract or term is substantively unconscionable if it shocks the conscience, is “monstrously harsh,” or is “exceedingly calloused.” *Nelson v. McGoldrick*, 127 Wn.2d 124, 131, 896 P.2d 1258 (1995) (citing *Montgomery Ward & Co. v. Annuity Bd. of S. Baptist Convention*, 16 Wn. App. 439, 444, 556 P.2d 552 (1976)). Courts have found arbitration provisions to be unconscionable where the agreement is obviously one-sided or the agreement works to prevent people from bringing claims.

For example, In *Adler v. Fred Lind Manor*, 153 Wn.2d at 355, 358, the court found that the arbitration agreement’s limitation period for filing employment discrimination claims that unfairly favored employer and attorney fees provision that required employee to waive his rights to recover statutory fees was unconscionable and unfairly favored employer. However, the court severed these provisions from the arbitration agreement and, recognizing the strong policy in favor of arbitration, compelled arbitration. *Id.* at 360.

In contrast, in instances where the arbitration provision effectively deprived the plaintiff of a means of recovery the court struck the

arbitration provision in its entirety. For example, in *Mendez v. Palm Harbor Homes, Inc.*, 111 Wn. App. 446, 45 P.3d 594 (2002), the court refused to compel arbitration. In *Mendez*, a purchaser of a used mobile home brought suit against the seller. The fee to initiate arbitration was approximately \$2,000. *Id.* at 466. Mr. Mendez was poverty stricken and the amount in controversy was approximately \$7,000. *Id.* The court refused to compel arbitration due to the “prohibitive entry costs of arbitration compared to the entry costs of trial.” *Id.* at 450. The court found that the arbitration fees were an “insurmountable barrier” to his claims. *Id.* at 467. The court also found that the arbitration provision in *M.A. Mortenson Co. v. Timberline Software Corp.*, 140 Wn.2d 568, 587, 998 P.2d 305 (2000), effectively precluded the plaintiff from bringing his claims because the arbitration provision required the use of a French arbitration company, payment of a nonrefundable advance fee, travel fees, and payment of the loser’s attorney fees.

Washington courts have also found substantive unconscionability if the arbitration provision prohibits class actions, either by its express terms or in effect. *Dix v. ICT Group, Inc.*, 160 Wn.2d 826, 837, 161 P.3d 1016 (2007) (holding that a forum selection clause that in effect precluded class actions was unenforceable); *Scott v. Cingular Wireless*, 160 Wn.2d 843, 855–57, 161 P.3d 1000 (2007) (holding that an arbitration provision

that expressly precluded class actions violated the policy behind the CPA and was therefore unconscionable). Courts have scrutinized arbitration agreements which prevent class actions because class actions often address claims with merit, but with nominal damages. Many claims are simply “too small to be worth the time and energy, let alone the nominal filing fee.” *McKee v. AT&T Corp.*, 164 Wn.2d 372, 397, 191 P.3d 845 (2008) (citing *Scott*, 160 Wn.2d at 856). Unless plaintiffs had the ability to pursue these claims in the aggregate, they would effectively have no meaningful ability to address their claims.

The Weiderts admit that costs are “not a significant factor” in this case. CP 124, lines 23 to 26. The costs associated with proceeding to arbitration in this instance are not an insurmountable barrier to Weiderts’ claims. Nor have the Weiderts addressed any other circumstance which prevents them from addressing their claims. Rather, the Weiderts assert that the arbitration provision is unconscionable because they cannot address their claims in a *single* forum.

In *In re ADM Investor Services, Inc.*, 304 S.W.3d 371 (Tex. 2010), the Texas Supreme Court rejected a claim. In *ADM*, the plaintiff sued two defendants, one of whom invoked a forum-selection clause that designated Illinois as the forum for litigation related to the contract. The trial court denied defendant ADM’s motion to dismiss, observing that it would be

unreasonable to force the plaintiff to sue the two defendants in different states. *Id.* The Texas Supreme Court rejected the trial court's reasoning and enforced the forum selection clause. The court specifically declined to recognize a right to sue multiple defendants in the same forum. *See id.* at 375. "The mere existence of another defendant does not compel joint litigation, even if the claims arise out of the same nucleus of facts." *Id.* Neither the added expense nor the possible tactical advantage of an "empty chair" defense were so harsh as to practically deprive the plaintiff her day in court.

The fact that there will be an empty chair in the litigation against Mr. Hanson is not "monstrously harsh" and does not deprive the Weiderts of the opportunity to make their claims.

There is no Washington case which has found unconscionability under these or similar circumstances. The Weiderts have not shown that the policy terms are unconscionable as a matter of law under Washington state law.

V. CONCLUSION

Under the terms of the parties' contract and the applicable federal law and regulations, any dispute regarding a determination by ProAg must be resolved through arbitration. *See* 7 C.F.R. § 457.8. Accordingly,

ProAg respectfully requests the reverse the finding of the trial court and allow this case to proceed to arbitration.

DATED this 2 day of April, 2011.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury under the laws of the State of Washington that on the 2nd day of April, 2012, I caused a true and correct copy of the foregoing document, "Brief of Appellant," to be mailed by United States mail postage prepaid to the following counsel of record:

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