

No. 91640-3

SUPREME COURT OF THE STATE OF WASHINGTON
COURT OF APPEALS, DIVISION III
CASE NO. 31837-1-III

INLAND EMPIRE DRY WALL SUPPLY, CO.,

Plaintiff/Appellant/Respondent,

v.

WESTERN SURETY CO.,

Defendant/Respondent/Petitioner.

**INLAND EMPIRE DRY WALL SUPPLY, CO.'S
SUPPLEMENTAL BRIEFING**

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I. INTRODUCTION

All we said in CalPortland was that a suit against both a bond principal and bond surety is sufficient for compliance with the lien release bond statute. The ruling did not address whether suit against both is necessary. Inland Empire Dry Wall Supply Co. v. W. Sur. Co., 197 Wn. App. 510, 515 (2017)

The above quote is the Court of Appeals' answer to Western Surety's errant misstatement that in CalPortland Co. v. LevelOne Concrete LLC, 180 Wn. App. 379 (2014), Division II had previously held that both bond surety and principal were necessary parties to an action to foreclose against a lien release bond. This typifies the fundamentally flawed nature of Western Surety's arguments in this matter. Western Surety's arguments are premised upon reading non-existent words, statements, and phrases into statutes and prior court opinions.

In that vein, Division III's opinion in Inland Empire does **not** conflict with the opinion in CalPortland. The two courts were addressing entirely separate issues. The opinion in Inland Empire is actually harmonious with CalPortland and adds additional clarity in interpreting Washington's mechanic's lien statute. Likewise, Division III's decision in Inland Empire does not ignore or subvert the intent of RCW 60.04.161 but instead brings further focus to the procedural requirements necessary for a mechanic's lien claimant to foreclose against a lien release bond.

For all of the reasons discussed by Plaintiff/Appellant/Respondent Inland Empire (“IEWS”) in the lower courts, and for all of the reasons discussed herein, IEWS respectfully requests this Court affirm the Division III’s decision in Inland Empire, supra, and remand the matter to the trial court with the appropriate orders and instructions.

II. STATEMENT OF THE CASE

Plaintiff/Appellant/Respondent IEWS incorporates the “Facts” summarized by the Court of Appeals below, see Inland Empire, supra, at 512–13; the statement of the case in its opening brief to the Court of Appeals, see Inland Empire App. Br., at pp. 9-13; and the statement of the case in its Answer to Petition for Review, see Pet. Answer at pp. 2-4.

III. ARGUMENT

A. The Surety’s Liability Is Not Conditioned Upon The Lien Claimant Successfully Litigating With The Principal.

There is no requirement that a lien claimant first obtain a judgment against or litigate the validity of a mechanic’s lien directly against the principal of a lien release bond. Western Surety here repeatedly makes the bald assertion that a lien claimant must litigate the validity of the lien directly against the bond principal. See Western Surety Resp. Brief, pp. 15, 18, 26, 27, 42-43. However, there is neither statutory nor common law support for this erroneous assertion. Instead, Western Surety adds

non-existent words to RCW 60.04.161 and points to the language of its own bond to craft this strained argument.

1. RCW 60.04.161 Does Not Condition The Surety's Liability Upon The Lien Claimant Successfully Litigating With The Principal.

...The condition of the bond shall be to guarantee payment of any judgment upon the lien in favor of the lien claimant entered in any action to recover the amount claimed in a claim of lien, or on the claim asserted in the claim of lien. The effect of recording a bond shall be to release the real property described in the notice of claim of lien from the lien and any action brought to recover the amount claimed. Unless otherwise prohibited by law, if no action is commenced to recover on a lien within the time specified in RCW 60.04.141, the surety shall be discharged from liability under the bond. If an action is timely commenced, then on payment of any judgment entered in the action or on payment of the full amount of the bond to the holder of the judgment, whichever is less, the surety shall be discharged from liability under the bond. RCW 60.04.161 (emphasis added).

RCW 60.04.161 refers twice to “the surety” and liability of “the surety.” However, the statute does not once mention the bond “principal” much less condition payment by the surety upon a claimant obtaining a judgment against the principal. Rather, the bond guarantees “*payment of any judgment upon the lien in favor of the lien claimant entered in any action to recover the amount claimed in a claim of lien, or on the claim*”

asserted in the claim of lien.”¹ Id. (emphasis added). In other words, the surety is obligated to satisfy a judgment entered by the court after the court determines that the claimant’s lien is valid and proper. Western Surety’s attempt to read into the statute an additional requirement, namely that the lien claimant obtain a judgment against the bond’s principal, stretches the bounds of creativity, much less credibility.

2. The Bond Does Not Condition The Surety’s Liability Upon The Lien Claimant Successfully Litigating With The Principal.

Western Surety’s contention that the language of the bond establishes that the surety’s liability is conditioned upon litigation against the principal is also ill conceived. The bond here states on its face:

WHEREAS, Fowler General Construction, Inc. does not wish to pay said lien until the validity of the lien can be properly determined or adjudicated.

NOW, THEREFORE, if the said Principal and Surety shall hold harmless the said Obligee from and against any loss, costs, or expenses which may accrue due to the filing of

¹ It is noteworthy that the statute authorizes the real property owner, contractor, subcontractor, lender or even another lien claimant to obtain and record a lien release bond and release the affected real property. See RCW 60.04.161. Any one of these authorized parties would then constitute the bond “principal.” However, the lien claimant, like Inland in this case, may not necessarily be in privity of contract with many of these potential “principals” and therefore would have no basis to obtain a judgment against them. For example, in this case, Inland was a material supplier for a subcontractor. The subcontractor had a direct contract with the general contractor (Fowler), whom in turn had a direct contract with the property owner. However, Inland had no contract with the principal (Fowler) and therefore no basis to obtain a judgment directly against the principal (Fowler). This scenario exemplifies why the principal is **not** a necessary party and why the statute expressly identifies the liability of the surety based solely upon the lien claimant obtaining judgment upon **the lien**, not against any other specific party.

said lien, then this obligation to be null and void, otherwise to remain in full force and effect.

See CP 23. The bond here recites that Fowler, the principal, desires to have the validity of the lien adjudicated. However, the bond does not specify that Fowler must be included as a necessary party for such adjudication. Assuming *arguendo* that the bond included a provision that the principal be a party to the subject litigation, such a requirement would be a contractual matter between the surety and the principal. Notably, such a provision in the bond would not have the force of redefining the lien claimant's obligations under the statutory scheme. Likewise, the surety's obligation on the face of the bond is not in any way premised upon entry of a judgment against the principal.

There is no legal authority establishing that the surety's liability is conditioned upon successful litigation against the principal. Division III in Inland Empire succinctly and properly explained "*the subject matter of the proceeding is still the validity of the originally recorded claim of lien, this continuity of subject matter does not control **who must be made party to the suit.***" Inland Empire, *supra*, at 518 (emphasis added).

3. General Suretyship Law Permits An Obligee To Assert A Claim Directly Against The Surety Without Simultaneously Pursuing The Principal.

Division III correctly stated “[c]ontrary to *Western’s protests*, there is no practical or logical impediment to pursuing a bond claim against only the surety. General suretyship principles apply.” *Id.*

The Restatement (Third) of Suretyship & Guaranty § 50, comment 1 (1996) states:

The obligee has two sets of rights, one set against the principal obligor and the other against the secondary obligor. It would diminish the attractiveness and utility of the secondary obligation if the obligee in all cases were obliged first to enforce its right against the principal obligor. Therefore, unless the parties agree to the contrary, the obligee may choose whether to seek enforcement first of the underlying obligation or the secondary obligation. Since the secondary obligor may seek enforcement of the principal obligor’s duty of performance (§ 21) even if the obligee has not sought enforcement of the underlying obligation, the obligee’s inaction generally affords no equitable basis for a claim of discharge by the secondary obligor. The rule stated in this section is most relevant when the financial condition of the principal obligor changes during the period of the obligee’s inaction. (Emphasis added)

This Court articulated the same principle when it held “*it is the general rule that, even though the creditor has a security interest in property of the principal, he may proceed first against the surety before resorting to the security interest.*” Warren v. Washington Trust Bank, 92 Wn.2d 381, 390 (1979). As the Inland Empire court correctly observed, “[t]his rule works

no injustice to the surety because, to the extent the surety requires the principal's assistance, the surety 'may seek enforcement of the principal obligor's duty of performance.' ” Inland Empire, supra, at 518.

Western Surety's analogy to Arizona, New York, Oklahoma, and Nevada statutes is not well taken. See Western Surety Resp. Brief, p. 20. Each of these statutes expressly state that **the principal shall** be made a party to any foreclosure action:

- A.R.S. § 33-1004(C) and (D)(2) — *...if a suit is then pending to foreclose the lien the claimant, within ninety days after receipt thereof **shall cause** proceedings to be instituted to add the surety and **the principal** as parties to the lien foreclosure suit... The bond shall be discharged and the principal and sureties released upon any of the following: ...[f]ailure of the lien claimant to name **the principal** and sureties as parties to the action seeking foreclosure of the lien if a copy of the bond has been served upon claimant.*
- N.Y. Lien Law § 37(7) — *The plaintiff in such an action must, prior to the commencement thereof, file in the office of the clerk of the county where the bond is filed, the summons and complaint in such action and **shall join** as parties defendant, **the principal** and surety on the bond, the contractor, and all claimants who have filed notices of claim prior to the date of the filing of such summons and complaint.*
- Okla. Stat. Ann. Tit. 42, § 147.1 — *The party making the cash deposit and **the bond principal** and surety are **necessary parties** to an action against the substituted security....*
- Nev. Rev. Stat. Ann. § 108.2421(2)(b) — *After the surety bond is recorded: If the surety bond is recorded pursuant*

*to subsection 1 of NRS 108.2415, the lien claimant may bring an action against **the principal** and the surety not later than 9 months after the date that the lien claimant was served with notice of the recording of the surety bond.²*

By contrast, nowhere in Washington’s mechanic’s lien statute is the lien release bond’s principal identified as an interested party, much less a necessary party to an action. See RCW 60.04, et seq. Unlike the states identified by Western Surety, Washington’s legislature has not deviated from the principles of general suretyship law within the mechanic’s lien statute. Rather, as the Inland Empire panel stated “[t]he procedural statute governing lien release bonds unambiguously identifies only the bond surety as an interested party.” Inland Empire, supra, at 511-12. Thus, the principles of general suretyship law are relevant and applicable, and confirm that a lien claimant may proceed directly against the surety without including the bond principal.

B. The Surety Has A Duty Of Good Faith To The Principal Which Includes The Duty To Dispute And Litigate With The Lien Claimant If The Surety Does Not Believe The Lien Is Correct And Valid.

Western Surety rests much of its argument upon the false premise that the surety is not obligated or required to dispute and litigate with the

² Notably, Nev. Rev. Stat. Ann. § 108.2421(2)(b) specifically and directly identifies and acknowledges “the principal.” However, the statute states the “*the lien claimant may bring an action against **the principal and the surety**...*,” thus, even this statute is unclear whether it is identifying permissive parties or whether it is identifying necessary parties in derogation of general suretyship law.

lien claimant the issue of the lien's correctness and validity. See Pet., pp. 16, 17; Resp. Brief, pp. 29, 35, 37. However, it is clear under Washington law that the surety is in fact obligated to litigate the validity of the lien.

As an initial matter, in order to obtain judgment foreclosing the lien, the lien claimant bears the burden of first establishing the lien's validity. S.D. Deacon Corp. of Washington v. Gaston Bros. Excavating, 150 Wn. App. 87, 91 (Div. I, 2009) (“*The lien claimant bears the ultimate burden of proof when it seeks to enforce the lien.*”); DKS Const. Mgmt., Inc. v. Real Estate Improvement Co., 124 Wn. App. 532, 536, (Div. III, 2004) (“*Accordingly, the burden of establishing the right to a mechanics’ lien rests upon the person claiming it.*”). Furthermore, the Court of Appeals has made clear the purpose of a lien release bond “*is to transfer the lien from the property to the bond to permit alienation of the property — it is not a concession that the lien is valid and correct.*” DBM Consulting Engineers, Inc. v. U.S. Fid. & Guar. Co., 142 Wn. App. 35, 41 (Div. I, 2007). Thus, Inland cannot obtain a judgment on the lien and foreclose against the bond without first litigating the validity and correctness of the lien. Id.

Furthermore, Western Surety is statutorily prohibited from confessing judgment or allowing a judgment by default where the surety is

notified of a valid defense. See RCW 19.72.090. Likewise, common law has long held that “[w]here the principal has a defense which is known to and available to a surety who has become a surety with the consent of the principal, and the surety does not assert it, or asserts it in an action without giving the principal notice of the action and an opportunity to defend it, or where the surety as well as the principal has a defense, the principal has no duty to reimburse the surety unless business compulsion requires performance by the surety.” Restatement (First) of Security § 108(5) (1941). In other words, a surety loses its right to indemnity against the principal if the surety fails to assert defenses available and beneficial to the principal of which the surety is aware.³

The same rule was confirmed by this Court when it stated that indemnification from the principal to the surety “*is not a foregone conclusion.*” Colorado Structures, Inc. v. Ins. Co. of the W., 161 Wn.2d 577, 605 n.2, 167 P.3d 1125, 1140, (2007). This court acknowledged that the right to indemnification is forfeited if the surety wrongfully pays an

³ It is also noteworthy that the Restatement holds that the surety loses the right to indemnity from the principal if the surety fails to notify the principal of the action and give the principal an opportunity to defend against the action. Id.

obligee.⁴ Id. The court stated “*the risk of a wrongful decision falls on the surety, not the principal.*” Id.

For these very reasons, as a general rule of suretyship, the surety is allowed to assert and rely upon any defense available to the principal. See McChord Credit Union v. Parrish, 61 Wn. App. 8, 13-14 (Div. II, 1991) quoting A. Stearns, *The Law of Suretyship* § 7.1, p. 200 (5th ed. 1951) (“*As a general rule, the surety is not liable to the creditor unless his principal is liable and, accordingly, he may plead any defense which the principal might have used if the action had been brought against him.*”).

Thus, it is clear that the surety has both the duty and the ability to dispute and litigate the correctness and validity of the lien with the lien claimant — if any such defense exists. “The sky is falling” assertion by Western Surety that the lien claimant is allowed to “*side step and strategically avoid litigating a disputed lien claim by only suing the surety*” is legally and factually misguided. See Resp. Brief, p. 28.

⁴ Western Surety repeatedly argues that the principal is the “ultimate stakeholder” because the principal holds an indemnification obligation to the surety and is therefore a necessary party to the lien foreclosure action. See Pet., pp. 16-17; Resp. Brief., p. 28. However, as discussed above, the principal’s duty to indemnify the surety is not a certainty. Furthermore, any duty which may exist by the principal to indemnify the surety arises out of the separate and wholly independent contractual relationship between the principal and surety. As such, it is unrelated and irrelevant to the lien foreclosure. It is also notable that “[t]he duty to indemnify arises when the plaintiff in the underlying action prevails on facts that fall within coverage.” George Sollitt Corp. v. Howard Chapman Plumbing & Heating, Inc., 67 Wn. App. 468, 475 (Div. II, 1992). Thus, no such duty to indemnify, if any, arises until **after** judgment is entered against the bond. Consequently, adjudication of any indemnification rights and obligations between the principal and surety are more appropriately addressed outside of the context of the lien foreclosure action.

Furthermore, Western Surety's argument is nothing more than a patently self-serving attempt to relieve itself of both the duty to litigate claims, generally, as well as to avoid liability for this particular claim.

C. **There Is No Conflict Between CalPortland, Inland Empire, And RCW 60.04, et seq., Because None Of These Authorities Identify A Bond Principal As An "Owner Of The Subject Property" Or A "Necessary Party" To A Lien Foreclosure Action.**

A plain reading of the mechanic's lien statute confirms that the statute provides for two separate procedures for lien claimants to proceed with a claim depending upon whether the lien is secured by real property or a bond. RCW 60.04.141 and RCW 60.04.171 provide the specific procedural mechanism for a lien claimant to proceed with a claim when the lien remains secured by real property. Likewise, RCW 60.04.161 provides for a release of lien bond to transfer the lien from real property to a surety bond in order to allow free alienation of the real property. See Olson Eng'g, Inc. v. KeyBank Nat. Ass'n, 171 Wn. App. 57, 66 (Div. II, 2012) ("*The purpose of RCW 60.04.161 is to allow a party to file a bond to support transferring to the bond a lien against the property to allow the party supplying the bond to free up the property for conveyance.*"). RCW 60.04.161 establishes the procedural mechanism for claimants enforcing a lien against a bond in lieu of real property.

Ten years ago, the Court of Appeals recognized and acknowledged that a different process applied to the lien foreclosure depending upon whether the lien was secured by real property or by a bond. See DBM Consulting Engineers, *supra*, at 42 (“*While the applicable foreclosure process depends on whether the lien is secured by property (which can then be sold) or by a bond, in either situation, the lien must be foreclosed upon before the lienholder is entitled to recover on the lien.*”) (emphasis added). This same concept was recognized and applied by Division III in Inland Empire when the Court stated “*once a lien release bond is recorded, the procedural statute shifts from RCW 60.04.141 to RCW 60.04.161. This change alters the governing legal landscape.*” Inland Empire, *supra*, at 516. Division III continued its analysis of RCW 60.04.161 by correctly explaining that “[o]nce a bond is filed, the statute operates to substitute the bond for the property. In like manner, application of the bond statute operates to substitute the bond surety for the property owner as the individual that must be sued in a timely manner.” *Id.* at 518 (emphasis added).

Western Surety errantly invited the trial court below and the Court of Appeals to borrow and replace terms from RCW 60.04.141 and RCW 60.04.161 to judicially create a statutory requirement under RCW 60.04.141. Western Surety is seeking to have this court do the

same. In other words, Western Surety urges the Court to construe RCW 60.04.141 to read that “*the owner of the subject* [bond]” must be served and joined as a party to the litigation. Western Surety advocates that its newly-fashioned requirement (“*the owner of the subject* [bond]”) thereafter be interpreted to actually mean “*the [principal] of the subject* [bond].” This contrived and entirely strained interpretation lacks any merit within the text of the statute.

The mechanic’s lien statute is devoid of any reference to the term “owner of the bond.” See RCW 60.04, et seq. Furthermore, the term “owner of the bond” is not a term of art utilized in suretyship law. The applicable terms of art related to a surety bond are: (1) the “obligee” or “creditor” (IEWS), (2) the “principal obligor” or simply the “principal” (Fowler), and (3) the “secondary obligor” or “surety” (Western Surety). See Restatement of Security § 82 (Am. Law Ins. 1941); Restatement (Third) of Suretyship and Guaranty, at IX-XI (Am. Law Inst. 1996).

It is clear our legislature understood these proper suretyship terms of art. Indeed, RCW 60.04.161 refers solely to discharging the liability of “the surety.” As noted above, there is not a single reference to the words “bond principal” or “principal obligor” anywhere within the mechanic’s lien statute. See RCW 60.04, et seq. Thus, it is clear Washington State’s legislature did not intend, in derogation of general suretyship principles,

that the principal of the lien release bond be a necessary party to the lien foreclosure.

In a desperate attempt to bolster its failing argument, Western Surety misconstrues Division II's holding in CalPortland Co. v. LevelOne Concrete LLC, 180 Wn. App. 379 (2014). It is important to note that the question of whether a bond principal was a necessary party to a lien foreclosure action was not an issue in CalPortland. Rather, the question before Division II in CalPortland was whether the owner of the real property originally subject to the lien was a necessary party to the foreclosure action after a lien release bond had been recorded pursuant to RCW 60.04.161.

Western Surety relies upon the following language “[b]ecause the plain language of the statute establishes that Costco’s realty was not ‘property subject to the lien’ for purposes of RCW 60.04.141’s procedural requirements, we reject Ferguson’s [principal] argument and hold CalPortland’s [lien claimant] service of process on Travelers [surety] and Ferguson sufficient.” Id. at 388. However, Western Surety conflates the above language by asserting that “sufficient” is tantamount to “minimum necessary.” See Western Surety Pet., p. 11. Contrary to Western Surety’s argument, this plain language does not define the minimum threshold requirements of RCW 60.04.141. Rather, the CalPortland court simply

held that serving both the bond principal and the surety satisfied the threshold, which the court did not further define. Division III in Inland Empire confirmed this analysis. Supra at 515 (“*All we said in CalPortland was that a suit against both a bond principal and bond surety is sufficient for compliance with the lien release bond statute. **The ruling did not address whether suit against both is necessary.**” (emphasis added).*

Thus, it is clear that the Court of Appeals decisions in CalPortland (Division II) and Inland Empire (Division III) are in accord with each other as well as with the statutory language of RCW 60.04, et seq. It is likewise clear that the principal of a lien release bond recorded pursuant to RCW 60.04.161 may be a permissive party but is not a necessary party in a lien claimant’s foreclosure action.

D. RAP 18.1 Motion For Attorney Fees And Costs.

Based on RAP 18.1, IEWS respectfully requests an award of reasonable attorney fees and costs incurred in filing its lien, its subsequent lawsuit, the appeal to the Court of Appeals, and this appeal to the Supreme Court. Pursuant to RCW 60.04.181(3), “[t]he court may allow the prevailing party in the action, whether plaintiff or defendant, as part of the costs of the action, the moneys paid for recording the claim of lien, costs of title report, bond costs, and attorneys’ fees and necessary expenses

incurred by the attorney in the superior court, court of appeals, supreme court ...as the court ...deems reasonable.” See Diversified Wood Recycling, Inc. v. Johnson, 161 Wn. App. 859, 890 (Div. I, 2011), as amended (July 11, 2011).

Based upon the foregoing, IEWS respectfully requests that the Court affirm the Court of Appeals opinion and remand this case back to the trial court for further proceedings along with directions to grant IEWS’s reasonable attorney fees and expenses incurred in the trial and appellate courts if the trial court determines IEWS to be the prevailing party.

IV. CONCLUSION

Based on the foregoing, Inland Empire Dry Wall Supply, Co. respectfully asks the Court for the following relief:

1. Affirm the decision of the Court of Appeals;
 2. Vacate the trial court orders granting summary judgment to Western Surety Company and dismissing Plaintiff’s Complaint with prejudice and releasing and discharging the subject release of lien bond;
- and

3. Award attorney fees and costs to IEWS pursuant to
RAP 18.1 and RCW 60.04.181(3).

DATED this 2 day of June, 2017.

DUNN & BLACK, P.S.

A handwritten signature in blue ink, appearing to read 'JCB', is written over a horizontal line.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 2nd day of June, 2017, I caused to be served a true and correct copy of the foregoing document to the following:

- | | | |
|-------------------------------------|------------------|--|
| <input type="checkbox"/> | HAND DELIVERY | Timothy G. Klashke |
| <input checked="" type="checkbox"/> | U.S. MAIL | Kuffel, Hultgren, Klashke, Shea
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