

No. 94711-2

**NO. 48644-0-II**

**COURT OF APPEALS, DIVISION II  
OF THE STATE OF WASHINGTON**

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**Nova Contracting, Inc.,  
Appellant**

**v.**

**City of Olympia,  
Respondent**

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**APPELLANT'S OPENING BRIEF**

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## **1. INTRODUCTION**

This case arises from the Trial Court's dismissal, on summary judgment, of Appellant Nova Contracting, Inc.'s (referred to herein as Nova or Nova Contracting) claim that the Respondent, City of Olympia, violated the Warranty of Good Faith and Fair Dealing by unreasonably exercising its contractual discretion in the review and evaluation of submittals on a public contract. In reaching this result, the Trial Court expressly weighed evidence under the preponderance of the evidence standard, also applying the abuse of discretion standard, and possibly applying, in the end, a "clear, cogent and convincing" evidence standard, as if this matter had come on as a bench trial rather than as summary judgment motion. The Court expressly acknowledged production of evidence and inferences sufficient to support Nova Contracting's claim, but, finding that evidence unpersuasive under the trial standards it applied, dismissed the case.

The Trial Court then, without further analysis or justification, granted judgment to the City of Olympia on the City's counterclaim for liquidated damages, even though the City of Olympia had failed to produce any evidence justifying either the imposition of liquidated damages or the rate of such damages.

## **2. ASSIGNMENTS OF ERROR**

1. The Court erred by applying trial standards of evidence and burdens of proof, dismissing the nonmoving party's claims because the

nonmoving party “failed to meet its burden of proof” under the “preponderance of the evidence” and the “abuse of discretion” standards.

2. The Court erred in requiring that Nova present evidence of actual bad faith by the City of Olympia to sustain a claim that the City of Olympia breached the Warranty of Good Faith and Fair Dealing.

3. The Court erred in ruling that Nova failed to produce evidence which presented a triable issue of disputed, material fact on which a jury could find for Nova on Nova’s claim that the City of Olympia breached the Warranty of Good Faith and Fair Dealing.

4. The Court erred in awarding the City of Olympia liquidated damages when there was no evidence that the City of Olympia suffered any actual or foreseeable loss or harm from the fact that the project was not performed.

### **3. ISSUES REALTED TO ASSIGNMENTS OF ERROR**

1. Does the non-moving party on summary judgment have a burden of proof under the preponderance of the evidence, abuse of discretion, or clear cogent and convincing evidence standard, or a burden of production only?

2. Does the Warranty of Good Faith and Fair Dealing require a showing of actual bad faith?

3. When a party to a contract produces evidence that the other party’s unreasonable exercise of discretion prevented contract performance, is

there a triable claim for breach of the Warranty of Good Faith and Fair Dealing, making summary judgment improper?

4. Are liquidated damages awardable even if the party seeking them fails to produce evidence of actual, foreseeable, incalculable damages?

5. Are liquidated damages awardable even when the party seeking them fails to produce evidence establishing that they are a fair and proper estimate of actual, foreseeable, but incalculable, damages?

#### **4. STATEMENT OF THE CASE**

##### **4.1 Facts Produced of Contractual Performance.**

This case arises from the Woodland Creek Culvert Improvement Project in Olympia, Washington. The project was awarded to Appellant Nova Contracting by Respondent City of Olympia. However, it was never completed and is now not being pursued by the City. Nova produced evidence that the failure of this project was the result of the City of Olympia Department of Public Works' mismanagement of the project, especially its unreasonable exercise of discretion when requiring and evaluating submittals. (CP 246-247, 249-253, 274, 277-278, and 316-320.)

The project was for repair of a deteriorating culvert under a "rails to trails" pedestrian and bike trail in the City of Olympia. The culvert had deteriorated over time, but was not failing. It was thus just like thousands of other culverts in the State of Washington. Further, the location and characteristics of the culvert were not particularly unusual. The scope of work

was relatively small and could have been performed in less than one month.

This should not have been a difficult project. (CP 246, 275, and 316.)

From the start, the City, or rather some of its key staff, appeared to want an alternative contractor (Rognlin's) to perform the work. (CP 274 and 275.) This may have motivated the City, or its staff, to actively undermine Nova's performance of the contract – and Nova presented evidence of this possibility sufficient to support an inference of actual bad faith. (CP 278.) However, even if not motivated by actual bad faith, the City failed to act reasonably in its exercise of contractual discretion with regard to submittals. (CP 248-254, 260-269, and 315-320.) Ultimately the City shut down the project, initially using the improper method of issuing a “stop work order,” which it followed up with a “termination for default.” (CP 347-248.)

In public construction, the submittal process exists to allow the public owner (in this case the City of Olympia) to exercise continuing discretion over the terms of the contract by providing for a review and approval process for proposed work prior to the contractor's performance of the work. (CP 250-251, 260-269.) As such, the City of Olympia had an obligation to exercise this discretion reasonably and in a manner that did not prevent contract performance and thus deprive Nova of the benefit of its bargain (performance of the work for payment). Nova presented evidence that Olympia acted unreasonably in its exercise of discretion regarding submittals. (CP 248-254, 260-269, and 315-320.)

#### **4.2 Additional Facts Produced in the Summary Judgment Proceedings through Expert Opinion.**

In addition to the testimony, through declaration, of the Nova personnel involved with this project, (CP 274-314 and 315-436), Nova supported its claim with an expert opinion and declaration from a well-qualified engineer, Mr. Frank Pita, PE. (CP 245-272.) Mr. Pita offered the opinion that the project was not a difficult or particularly environmentally sensitive one (CP 246), that the ultimate cause of project failure was the City's issuance of a "stop work order" preventing Nova from proceeding with the work, which the City issued instead of following the mandated contractual termination procedure (CP 246-247), but that the project was already on track for failure due to the City's unreasonable exercise of its discretion in the submittal process (CP 249-254). Mr. Pita ultimately concluded that the City's unreasonable exercise of discretion and mismanagement of the project wholly and unnecessarily prevented Nova from performing it, and therefore the "responsibility for the non-performance of this project ... rests on the City of Olympia." (CP 254-255.)

In its decision, the Trial Court appears to have accepted Mr. Pita as a qualified expert. The only specific evidence the Trial Court cited was, in fact, a sentence from Mr. Pita's declaration – "It is my understanding that Nova is not claiming that the City acted improperly by reasonably rejecting submittals," but then failed to complete the sentence, which reads "but the City

is obligated to reasonably review submittals in an efficient manner reasonably calculated to advance project performance and to allow the Contractor to perform the work.” (RP 30: 3-5.) In fact, Mr. Pita continues to drive the point home by stating:

That is, Nova cannot claim extra time and money merely because its submittals are rejected, but can do so if the City is preventing contract performance by failing to approve proper submittals (as happened here). In my opinion, Nova’s submittals should have been approved or approved conditionally and Nova should have been allowed to proceed with the work. The City’s failure to approve the submittals and allow Nova to work was unreasonable, and may have been an intentional attempt to prevent Nova’s contract performance. This is a breach of contract by the City that completely prevented Nova from performing the work. Because Nova’s failure to perform the work was the result of the City’s prior breach in refusing to approve proper and acceptable submittals, the City, and not Nova, is at fault for the failure of this project.

(CP 253-254.)

That is, the Court’s decision was based on its reading, out of context, a dependent clause in a sentence that set up and then rejects a hypothetical case that would have provided for no liability on the City in favor of a factually supported case that provides for such liability. To make matters worse, the Court construed this evidence in the light most favorable to the moving party, and against the non-moving party, contrary to the proper standard for evaluating evidence in summary judgment.

#### **4.3 The Trial Court's Dismissal of Nova's Claims on Summary Judgment.**

The mishandling of Mr. Pita's testimony was not an isolated event. It was the result of a systemic error in the Trial Court's review and evaluation of the evidence produced in the summary judgment motion, which error infects the Trial Court decision from start to finish.

The Trial Court starts its substantive decision by announcing that it will "call the case," which proved to mean "weigh the evidence" rather than evaluate it in the light most favorable to the non-moving party. Further, the Court expressly announced that it was weighing the evidence under trial standards and burdens of proof – preponderance of the evidence and the abuse of discretion standard. This was error.

But I have to call this as I see it. And so I like to get to the point as well rather than keep people hanging, so I will get to that point, and I do feel that the city is entitled to summary judgment in this case. I'm going to grant summary judgment. My bases for doing so is while there are lots of issues that could be talked about as to what occurred, when it occurred, why it occurred, I don't find that after the city made their motion for summary judgment that Nova in their response raised a sufficient issue by the standard that's required. And the issue I guess I need to address, is that an issue of a preponderance of the evidence, is that an issue of showing that there's been arbitrary and capricious standard. I heard arguments about that. I don't think I have to make that decision. I simply do not find that Nova has sufficiently raised an issue that there was a breach by the city in not accepting certain submissions.

RP 27:20- 28:13.

Applying this standard, the Trial Court specifically announced that it was making “findings” and that it found that Nova had failed to meet its burden of proof, despite producing evidence on point.

I am finding that the contract was a bargained for exchange between two parties. There was a provision in the contract that said that the engineer had the right to approve submissions. I do not think that under these circumstances it's been proven sufficiently by the plaintiff, by Nova that there was some inappropriate or bad faith utilized by the city engineer. I do recognize that there are allegations that, well, at least one city official said they didn't want to see the same thing happen in this case that had happened previously and that showed bias in this case. I don't find there's a sufficient showing of bias.

RP 29:3-15

Finally, after applying the wrong standard of evidence and an improperly lopsided burden of proof, the Court evaluated the evidence based on an improper interpretation of the law concerning the Warranty of Good Faith and Fair Dealing, which the Court ruled required that a claimant prove actual bad faith, possibly under a “clear and convincing evidence standard.”

I read materials looking to see if there was a clear showing, in my opinion, that the city had bad faith motives for their decisions. I don't find that that's been anything more than a suggestion. It's surely not established, in my opinion. Therefore, there is no showing of a lack of good faith cooperation in this case. I will concede that in a contract a court would need to consider whether or not either party failed to carry out the duties of the contract in good faith; however, I'm not going there in this case because I don't believe that Nova has established that there wasn't good faith.

As a matter of fact, I do note that Mr. Pita acknowledged that Nova was not claiming that the city acted improperly by reasonably rejecting submittals. What the argument apparently was and is, is that some of the submittals were not handled

effectively. I don't find a showing of bad faith has been set forth sufficiently, so I am today granting summary judgment.

RP 29:16-30:10.

Finally, on this basis, the Court concluded that Olympia was not only entitled to dismissal of Nova's case, but also to an affirmative award on its counter-claim for liquidated damages even though Nova had challenged those damages as unsupported by reasonably foreseeable harm as required by law. The Trial Court failed to even evaluate the propriety of the liquidated damages or consider the utter lack of justifying evidence for the imposition of liquidated damages.

That brings up the issue that's not really been argued in great detail about liquidated damages, but I'll just tell you that I believe the city is entitled to liquidated damages. I will note that there was a concession by the city as to what those liquidated damages would be. I don't want to interject myself in that situation since you've made that particular statement or position known.

RP 30:11-18.

## **5. SUMMARY OF ARGUMENT**

The Trial Court granted the City of Olympia Motion for Summary Judgment, explaining its reasoning and decision on the record. A review of that reasoning shows that it is riddled with fatal errors from start to finish. The Court erred both in process, applying an improper evidentiary standard and burden of proof (preponderance of the evidence and abuse of discretion) and in substantive law (incorporating a subjective *mens rea* element into the objective standard of the Warranty of Good Faith and Fair Dealing).

The Trial Court appears to have recognized the qualifications of Nova's expert and that Nova produced evidence supporting its claim, both directly and by inference. However, the Trial Court handled this evidence as if this matter had come on as a bench trial rather than as a summary judgment, ultimately weighing the evidence (rather than construing it in the light most favorable to Nova as the non-moving party) and ruling that Nova had failed to meet its "burden of proof" (rather than the "burden of production" applicable in a summary judgment motion).

The Trial Court also applied an erroneous substantive legal standard for the Warranty of Good Faith and Fair Dealing. The Warranty of Good Faith and Fair Dealing applies when a party has discretion to impose, define or require some performance or contractual term during performance. The Warranty is breached if the party with discretion exercises it in a manner that prevents performance of the contract and thus denies the other party the benefit of its bargain. The Trial Court improperly added a subjective, *mens rea* element (actual bad faith) to the Warranty of Good Faith and Fair Dealing, which properly has an objective, performative standard.

While bad faith may prevent contract performance and thus violate the Warranty of Good Faith and Fair Dealing, it is not the only way the warranty can be breached. Any exercise of discretion that prevents contract performance breaches the warranty. That is, the warranty can be breached by negligence or other inadvertent mismanagement of discretion even without actual bad faith.

Thus, the Trial Court not only imposed an improper burden of proof on Nova, it required Nova to prove, as the lynchpin of its case, an element of the claim that is not a proper element at all.

Finally, having improperly concluded that Nova failed to meet its burden of proof on the claim for breach of the Warranty of Good Faith and Fair Dealing, the Trial Court erroneously concluded that it followed, as a matter of course, that Olympia was entitled to judgment on its counterclaim for liquidated damages. The Court concluded this even though Olympia had failed to justify those liquidated damages, either as appropriately imposed as liquidated damages, or to justify the rate of liquidated damages. The Court entered judgment for Olympia for its full liquidated damages request and struck the trial.

The Trial Court's decision is erroneous, both procedurally and substantively. This Court should reverse and remand this matter for trial on the merits of the evidence produced at Summary Judgment.

## **6. ARGUMENT**

### **6.1 Summary Judgment Rulings are Reviewed *de novo*.**

This Court reviews summary judgment orders *de novo*. *Schmitt v. Langenour*, 162 Wn. App. 397, 404, 256 P.3d 1235 (2011). The Court engages in the same inquiry as the trial court. *Labriola v. Pollard Group, Inc.*, 152 Wn.2d 828, 832, 100 P.3d 791 (2004). A court may grant summary judgment only if the pleadings, affidavits, and depositions establish that there

is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *Ruff v. County of King*, 125 Wn.2d 697, 703, 887 P. 2d 886 (1995); see also CR 56(c). Thus, the non-moving party has a burden of production, but not a burden of proof, and the Court errs if it grants summary judgment in the face of produced evidence based on a weighing of the evidence under a burden of proof. Further, in determining the existence of an issue of material fact, the court views all facts and inferences in favor of the nonmoving party. *Michael v. Mosquera-Lacy*, 165 Wn.2d 595, 601, 200 P.3d 695 (2009). On summary judgment, however, the court does not weigh the evidence presented or make witness credibility determinations. *American Exp. Centurion Bank v. Stratman*, 172 Wn. App. 667, 676, 292 P. 3d 128 (2012). “[A] court must deny summary judgment when a party raises a material factual dispute.” *Smith v. Safeco Ins. Co.*, 150 Wn.2d 478, 485-86, 78 P.3d 1274 (2003).

Here, the Trial Court applied incorrect standards for evaluating the evidence. The Court required Nova, the non-moving party, to meet a burden of proof, not merely a burden of production, and then weighed the evidence, failing to evaluate the evidence, and inferences from the evidence, in the light most favorable to the non-moving party. This was error. This case should be remanded for proper consideration of the evidence and argument presented at Summary Judgment under the Summary Judgment standard.

## 6.2 The Duty of Good Faith and Fair Dealing.

There is inherent in every contract an "implied duty of good faith and fair dealing" which "obligates the parties to cooperate with each other so that each may obtain the full benefit of performance." *Badgett v. Security State Bank*, 116 Wn.2d 563 at 570, 807 P.2d 356 (1991); RESTATEMENT (SECOND) OF CONTRACTS § 5 (1981). See also, *Metropolitan Park Dist. v. Griffith*, 106 Wn.2d 425, 437, 723 P.2d 1093 (1986). The goal of the implied covenant is to ensure that each of the parties to the contract obtains the full benefit of performance. "The duty of good faith requires 'faithfulness to an agreed common purpose and consistency with the justified expectations of the other party.'" *Edmonson v. Popchoi*, 172 Wn.2d 272, 280, 256 P.3d 1223 (2011) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 205, cmt. a (1981)); *Scribner v. Worldcom, Inc.*, 249 F.3d 902, 910 (9th Cir. 2001); *Amoco Oil Co. v. Ervin*, 908 P.2d 493, 498 (Colo. 1995).

Where one party retains discretion to determine certain terms of a contract, a party breaches the duty of good faith and fair dealing simply by disregarding the other party's justified expectations under the contract. *Scribner*, 249 F.3d at 909; see also, *Edmonson*, 172 Wn.2d at 280-81 (holding that contract's warranty to defend against a claim to title was subject to the duty of good faith, requiring more of grantor than indifference to the dispute and a concession of the claim without consideration of the merits motivated by economic self-interest); *Frank Coluccio Const. Co., Inc. v. King County*, 136

Wn. App. 751, 766, 150 P.3d 1147 (2007). Because of the potential that one party will exercise that discretion in a manner that undermines the fair and reasonable expectation of the other party, a party with discretion under a contract must perform its contractual obligations in a manner that is reasonable and reasonably calculated to allow for full contract performance by both parties and the full realization of the contractual expectancy of both parties. See, *Carma Developers (Cal.), Inc. v. Marathon Dev. Cal., Inc.*, 2 Cal.4th 342, 372, 826 P.2d 710 (1992); *Amoco Oil Co.*, *supra*, 908 P.2d at 498-99. Accordingly, settled Washington law applies the duty of good faith and fair dealing to contracts that "give[] one party discretionary authority to determine a contract term." See, *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*, 86 Wn. App. 732, 738, 935 P.2d 628 (1997). Thus, where a party retains discretion to exercise performance of a material contract term, the implied duty of good faith and fair dealing imposes a requirement that such discretion be exercised reasonably. See, *Scribner*, *supra*, 249 F.3d at 909-11 (applying Washington law and holding that even where corporation had broad discretion to interpret stock option contract, it violated the implied duty of good faith and fair dealing when it interpreted a contract term in a way that undermined the employee's justified expectations).

The Washington approach to the Warranty of Good Faith and Fair dealing is explained, with emphasis on its limitation in *Rekhter v. Dep't of Soc. & Health Servs.*, 180 Wn.2d 103, 323 P.3d 1036 (2014). The *Rekhter* court

started by noting the general proposition that an implied Warranty of Good Faith and Fair Dealing obligates the parties to a contract to cooperate with each other so that each may obtain the contract's full benefit. *Rekhtor* at 112. The Court then noted that, in Washington, implied Warranty of Good Faith and Fair Dealing does not impose a free-floating obligation of good faith on the parties. *Rekhtor* at 113. Instead, it arises when one party has discretionary authority under the contract, but then it requires that a party exercise that discretion in a manner calculated to preserve the reasonable contractual expectancy of the other party – that is, reasonably. *Rekhtor* at 112-113. To summarize, when a party to a contract has discretion to set a future contract term (or define the limits and scope of a contract term during contract performance, the implied Warranty of Good Faith and Fair Dealing applies to that term and this requires that the party with discretion exercise that discretion reasonably and in accordance with industry standards because the other party had a right to expect such reasonable performance consistent with industry practice.

**6.2.1. The Trial Court Applied Improper Standard by Incorporating a *Mens Rea* Element into the Warranty of Good Faith and Fair Dealing.**

As discussed below, this finding that the City of Olympia had not acted in bad faith was contrary to the evidence produced for the Summary Judgment Motion. Further, the Court's granting of Summary Judgment based on a finding of fact on an issue in dispute was itself reversible error.

However, there is also a fundamental legal error at the heart of the Trial Court's ruling – the Trial Court's inclusion of actual bad faith as a *mens rea* element of a claim for breach of the implied Warranty of Good Faith and Fair Dealing. The heart of the Court's ruling was:

I read materials looking to see if there was a clear showing, in my opinion, that the city had bad faith motives for their decisions. I don't find that that's been anything more than a suggestion. It's surely not established, in my opinion. Therefore, there is no showing of a lack of good faith cooperation in this case. I will concede that in a contract a court would need to consider whether or not either party failed to carry out the duties of the contract in good faith; however, I'm not going there in this case because I don't believe that Nova has established that there wasn't good faith.

RP 29:16-30.2

This ruling contains two central errors. First, the Trial Court ruled that a claim for breach of the Warranty of Good Faith and Fair Dealing required a showing of actual bad faith or malice as a *mens rea* element of the claim. This is contrary to law. The Warranty of Good Faith and Fair Dealing is more than a mere obligation not to engage in a contract with bad faith. It imposes objective obligations not to hinder, delay, or obstruct contract performance and to exercise discretion reasonably. These obligations go well beyond mere lack of bad faith.

It appears that the Trial Court made the mistake of applying its understanding of the name of the doctrine (“Warranty of *Good Faith* and Fair Dealing) rather than the elements of that doctrine as defined by Common Law.

This mistake is rather like requiring a showing of actual fraud in a Statute of Frauds case. Both the Warranty of Good Faith and Fair Dealing and the Statute of Frauds were created to avoid the evils mentioned in their names (bad faith and fraud respectively), but they do so by imposing objective standards of conduct that keep people well windward of the shoals, rather than acting as direct prohibitions of the conduct where it is found.

By ruling that the Warranty of Good Faith and Fair Dealing could be breached only in cases of proven bad faith, the Court applied an improperly narrow standard. This was error. This Court should reverse and remand this matter so that Nova's evidence that Olympia exercised its discretion unreasonably can be evaluated through the proper standard for breach of the Warranty of Good Faith and Fair Dealing.

**6.2.2 Breach of the Warranty of Good Faith and Fair Dealing is a Question of Fact, and Nova Produced Evidence Sufficient to Survive Summary Judgment, even Applying the Trial Court's Improper Standard.**

The second central error, which is an error found throughout the Trial Court's ruling, is that the Court weighed the evidence and ruled that Nova had failed to make "a clear showing" that "the city had bad faith motives for their decisions." The Court ruled that without a "clear showing" of bad faith, with the burden of proof on Nova, Nova's claim for Breach of the Warranty of Good Faith and Fair Dealing should be dismissed on summary judgment. The Court dismissed that claim, although it further noted that the evidence "suggested"

that there could even be actual bad faith in addition to the unreasonable exercise of discretion (which was clearly established by the evidence). That is, the Court appeared to explicitly recognize inferences that a jury could draw in favor of the non-moving party, which would sustain a trial burden of proof, but disregarded those inferences by prematurely applying the trial burden of proof as if this case came on as a bench trial rather than as a summary judgment motion.

The Warranty of Good Faith and Fair Dealing is breached if a party with discretion under the contract exercises that discretion unreasonably. As with all instances of the “reasonableness standard” – it is a question of fact whether a party acts unreasonably. (Reasonableness is an issue of fact, which must be resolved by a jury if reasonable minds may differ as to the reasonableness of an act or contract term. See, for example, *Gordon v. Deer Park School Dist.* 414, 71 Wn.2d 119, 426 P.2d 824 (1967).) Further, even if there were a *mens rea* element to the required proof for breach of the Warranty of Good Faith and Fair Dealing, that *mens rea* element would itself be a matter of fact.

On summary judgment, the non-moving party has a burden of production, not a burden of proof, on issues of fact, and the evidence produced should be taken in the light most favorable to the non-moving party, even to the point of using fair inferences to bridge arguable gaps in the evidence. In this case, Nova presented strong evidence that the City of Olympia exercised its

discretion unreasonably (CP 277-278, 315-320), Nova further presented an expert opinion that this unreasonable exercise supports a fair inference of actual bad faith (CP 253-254). Despite this showing, the Court, weighing the evidence under an improper trial standard, found it wanting and dismissed Nova's claims. This was error. This case should be remanded for proper consideration of the evidence and argument presented at Summary Judgment under the Summary Judgment standard.

### **6.3 The City of Olympia is Not Entitled to Liquidated Damages.**

In addition to dismissing Nova's claims against the City of Olympia, the Trial Court granted the City of Olympia summary judgment on its breach of contract claim and awarded the City of Olympia liquidated damages.

#### **6.3.1 Summary Judgment on Olympia's Breach of Contract Counterclaim was Not Appropriate.**

This case fundamentally involves cross-claims for breach of contract arising from a construction project that failed to launch. Both parties blame the other for this failure. The City of Olympia contended that Nova Contracting failed to provide it with the proper submittals. Nova contended that it did submit proper submittals and that the City wrongfully rejected them, thus preventing performance. Both parties produced evidence of their position and this evidence should have been subjected to and evaluated through trial. That is, this case involves fundamental disputed issues of material fact as to which party breached, when, and whether prior breaches by one party prevented the

performance of the other. Summary Judgment, either dismissing or granting a claim, is not appropriate in the face of such factual disputes.

### **6.3.2 The City of Olympia is Not Entitled to Liquidated Damages Based on the Evidence Produced in Summary Judgment.**

“A liquidated damage clause becomes a penalty when the amount fixed has an *in terrorem* effect of inducing performance rather than compensating loss.” *Rowland Constr. v. Beall Pipe*, 14 Wn. App. 297 at 312, 540 P.2d 912 (1975), citing to *Management, Inc. v. Schassberger*, 39 Wn.2d 321, 326, 235 P.2d 293 (1951); *Brower Co. v. Garrison*, 2 Wn. App. 424, 433, 468 P.2d 469 (1970). This is such a case.

Liquidated damages are generally available as a means through which parties can resolve the uncertainty of the actual damages a party would suffer as a result of performance delays. However, to be enforceable, a liquidated damages provision must meet three requirements: (1) the liquidated sum or rate must be a reasonable approximation of what the nonbreaching party’s damages will actually be; (2) the nonbreaching party’s damages must be difficult or impossible to predict accurately, and (3) the liquidated damages clause, as applied in the case, must not be unconscionable. *N.W. Acc. Corp. v. Hesco Constr.*, 26 Wn. App. 823 at 827-28, 614 P.2d 1302 (1980), citing to *Brower Co. v. Garrison*, 2 Wn. App. 424, 432, 468 P.2d 469 (1970); and *Management, Inc. v. Schassberger*, 39 Wn.2d 321, 326, 235 P.2d 293 (1951) The liquidated

damages provision the City of Olympia sought seek to enforce fails all these tests.

Reasonableness is an issue of fact, which must be resolved by a jury if reasonable minds may differ as to the reasonableness of an act or contract term. See, for example, *Gordon v. Deer Park School Dist.* 414, 71 Wn.2d 119, 426 P.2d 824 (1967). In the liquidated damages context, a liquidated damages clause is not enforceable unless it was a reasonable forecast of unpredictable actual damages at the time the contract was formed. If reasonable minds may disagree about the reasonableness of the predictions involved in a liquidated damages clause, an issue of fact exists and the issue must be resolved by evidence presented at a hearing on the merits. In this case, there is great doubt as to whether the City has suffered any damages at all as a result of this project not being performed. The City delayed performance of this project until the last chance available under an applicable permit, has not rescheduled the project, and appears not to have sought the permit necessary to do so. (CP 280.) Liquidated damages are not available when a party suffers no damage from delay because the performance of the contract is a matter of convenience rather than urgency.

Further, liquidated damages are only appropriate when actual damages could not have been accurately predicted during contract formation. Even in the absence of perfect predictability, the liquidated damage amount must fall within the predicted range of actual damages. If different circumstances of

delay would result in different levels of actual damages, a liquidated damages clause should provide for different recoveries based on the anticipated differences in actual damages. *Rowland Constr. v. Beall Pipe*, 14 Wn. App. 297 at 312-13, 540 P.2d 912 (1975). Here, because this contract appears to be one of convenience rather than urgency, there are no actual damages from the indefinite delay of performance so the range of damages into which liquidated damage must fall is the set of numbers between zero and zero.

Liquidated damages clauses are also not enforceable if they are unconscionable. A clause may be unconscionable in two ways – procedurally unconscionable or substantively unconscionable. If a clause is both procedurally and substantively unconscionable, Courts will refuse to enforce it. This liquidated damages clause, if applied to Nova, would be both procedurally and substantively unconscionable.

While it is extremely difficult to articulate an operational definition of unconscionability, those cases interpreting the doctrine appear to fall within two classifications: (1) substantive unconscionability; and (2) procedural unconscionability. 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. J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 4-2, at 117 (1972). In Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965), the court pronounced that procedural unconscionability was best described as a lack of "meaningful choice." In discussing the various factors to be considered in determining whether a meaningful choice is present, the court noted that consideration must be given to "all the circumstances surrounding the transaction," including "[t]he manner in which the contract was

entered," whether each party had "a reasonable opportunity to understand the terms of the contract," and whether "the important terms [were] hidden in a maze of fine print . . ." Williams v. Walker-Thomas Furniture Co., supra at 449; Reynolds v. Preferred Mut. Ins. Co., 11 U.C.C. Reporting Serv. 701 (Mass. App. 1972).

*Schroeder v. Fageol Motors*, 86 Wn.2d 256 at 259-60, 544 P.2d 20 (1975).

While a determination of whether a contract is unconscionable is a question of law for the Court, it is a legal determination that must be made based on the "totality of the circumstances." Therefore, while unconscionability is a question of law, it often turns on issues of fact and is, therefore, often not an appropriate issue for summary judgment. *Nelson v. McGoldrick*, 127 Wn.2d 124 at 133-34, 896 P.2d 1258 (1995).

First, a contract is procedurally unconscionable if, considering all the circumstances surrounding the transaction including "[t]he manner in which the contract was entered,' one of the parties lacked a meaningful ability to negotiate or effect the terms of the contract, if that party lacked 'a reasonable opportunity to understand the terms of the contract,' or whether 'the important terms [were] hidden in a maze of fine print . . .'" *Schroeder* at 260. Further, this analysis can be short-cut if the contract is a contract of adhesion. A contract of adhesion is procedurally unconscionable as a matter of law – although it may not be unenforceable unless it is also substantively unconscionable. *Blakely v. Housing Authority of King Cy.*, 8 Wn. App. 204 at 213, 505 P.2d 151 (1973).

The contract is a contract of adhesion if (1) the contract was "prepared by one party and submitted to the other on a 'take it or leave it' basis", and (2) there was "no true equality of bargaining power" between the parties. *Blakely* at 212-13, 505 P.2d 151 (1973), citing to *Standard Oil Co. v. Perkins*, 347 F.2d 379 (9th Cir. 1965), and (3) A. Corbin, Contracts § 559 at 271 (1960).

Public contracts are, by their very nature, contracts of adhesion. Public bidding law prohibits bidders and public agencies from negotiating the terms of the contracts. Contracts are offered to potential bidders on a "take it or leave it basis." *Platt Electric v. Seattle*, 16 Wn. App. 265 at 273-74, 555 P.2d 421 (1976). In fact, it is completely illegal for a bidder on a public contract to attempt to negotiate a term and any contract formed after such negotiation is void as an illegal contract. *Hanson Excavating v. Cowlitz Cnty.*, 28 Wn. App. 123 at 125-27, 622 P.2d 1285 (1981).

The public bidding system is designed to give the public agencies the best contract work for the best contract price – but it achieves this end by refusing to allow public bidders any bargaining power and by requiring that they bid on and accept public contracts on a "take it or leave it basis." That is, public contracts serve the public good because they are contracts of adhesion. However, as contracts of adhesion, the terms of such public contracts must be scrutinized under unconscionability analysis and, if the terms are unfair and substantively unconscionable, they cannot be enforced.

Public contracts are no different from any other contracts of adhesion in this regard.

"Substantive unconscionability involves those cases where a clause or term in the contract is alleged to be one-sided or overly harsh".

*Schroeder, supra* at 260, see also *Nelson, supra* at 131. In this case, the liquidated damages provision is both one-sided and is unduly harsh. It provides Olympia with a windfall benefit, rewarding it for preventing the performance of a contract it didn't need to have performed by exacting an undue penalty from Nova.

The City of Olympia's claim for liquidated damages is disputed both as to basic entitlement (which party is responsible for delay and whether such a clause is applicable at all on these facts) and as to reasonable amount. Therefore, summary judgment was not appropriate. The Trial Court erred in granting summary judgment on this claim and entering judgment for Olympia.

## **7. CONCLUSION**

The Trial Court's ruling granting the City of Olympia's summary judgment in this case is riddled with fatal errors from start to finish, both as a matter of process and in substantive law. Although this case came on as a Motion for Summary Judgment, the Court applied a standard of evidence and a burden of proof as if the case were a bench trial, ultimately ruling that Nova,

the non-moving party, had failed to prove its case by a preponderance of the evidence even though Nova had produced evidence justifying its claims.

The Trial Court also applied an erroneous substantive legal standard for the Warranty of Good Faith and Fair Dealing. The Warranty of Good Faith and Fair Dealing applies when a party has discretion to define or require some performance or contractual term, which is left more or less open for the exercise of the discretion at the time of contract formation. The Warranty is breached if the party with discretion exercises it in a manner that undermines, rather than facilitates, the performance of the contract and the parties' mutual recognition of the benefit of their bargain. The Trial Court improperly added a *mens rea* element (actual bad faith) to the Warranty of Good Faith and Fair Dealing.

While bad faith in the exercise of discretion may violate the Warranty of Good Faith and Fair Dealing, it is not the only way the warranty can be violated. Any exercise of discretion that undermines, rather than facilitates, contract performance breaches the warranty. That is, the warranty can be breached by an unreasonable or mismanaged exercise of discretion even without actual bad faith. Thus, the Court not only imposed an improper burden of proof on Nova, the Court imposed an improper proof on Nova.

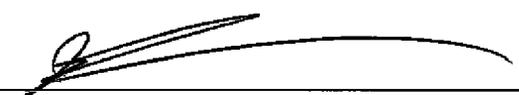
Finally, having improperly concluded that Nova's claim for breach of the Warranty of Good Faith and Fair Dealing failed to meet its burden of proof, the Court blithely and erroneously concluded that this meant that Olympia was

entitled to judgment on its counterclaim for liquidated damages even though Olympia had failed to justify those damages, either as appropriately imposed to compensate the City for actual, foreseeable, but incalculable, damages, or the justify the rate of liquidated damages. The Court entered judgment for Olympia and struck the trial.

The Trial Court's decision is erroneous, both procedurally and substantively. This Court should reverse and remand this matter for trial on the merits of the evidence produced at Summary Judgment.

SUBMITTED this 5<sup>th</sup> day of July, 2016.

CUSHMAN LAW OFFICES, P.S.



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CERTIFICATE OF SERVICE

I certify that on the date signed below, I e-filed the foregoing document with this Court, and served it upon Respondent's attorneys via email and legal messenger.

DECLARED UNDER PENALTY OF PERJURY ACCORDING TO  
THE LAWS OF THE STATE OF WASHINGTON.

Dated this 5<sup>th</sup> day of July, 2016, in Olympia, Washington.

  
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**July 05, 2016 - 2:15 PM**

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