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NO. 62991-3-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

GREG and LAURIE NEWHALL,

Appellants,

v.

COMMONWEALTH LAND TITLE, et al.,

Respondents.

APPELLANTS' REPLY BRIEF

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ORIGINAL

Table of Contents

I.	INTRODUCTION	1
II.	ARGUMENT	2
	A. <i>Moen's</i> Actual Liability Standard, Not Tort-Based "Reasonableness" Considerations, Controls the Outcome of this Case.	2
	B. The Indemnity Agreement Applies To Commonwealth, But Not Transnation.....	10
	1. The indemnity agreement explicitly applies to only Commonwealth.....	11
	2. Commonwealth drafted the agreement, so any ambiguities must be construed against it.	14
	3. Extrinsic evidence does not support an extension of the agreement to Transnation.	14
	4. Equitable Estoppel does not apply.....	17
	C. There Is A Genuine Issue Of Material Fact Regarding The Exact Amount Of Damages For Which Commonwealth Would Have Been Liable.	20
III.	CONCLUSION.....	21

Table of Authorities

Cases

<i>Berg v. Hudesman</i> , 115 Wn.2d 657, 801 P.2d 222 (1990)	14, 15
<i>Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1</i> , 124 Wn.2d 816, 881 P.2d 986 (1994)	18
<i>Cheney v. City of Mountlake Terrace</i> , 20 Wn. App. 854, 583 P.2d 1242 (1978).....	6, 7
<i>Gilbert H. Moen Co. v. Island Steel Erectors, Inc.</i> , 128 Wn.2d 745, 912 P.2d 472 (1996)	passim
<i>Guy Stickney, Inc. v. Underwood</i> , 67 Wn.2d 824, 410 P.2d 7 (1966)	14
<i>Hearst Communications, Inc. v. Seattle Times Co.</i> , 120 Wn. App. 784, 86 P.3d 1194 (2004).....	17
<i>Heights at Issaquah Ridge Owners Ass'n v. Derus Wakefield I, LLC</i> , 145 Wn. App. 698, 187 P.3d 306 (2008).....	8
<i>Heppler v. J.M. Peters Co.</i> , 87 Cal.Rptr.2d 497, 512 (Cal.App. 4 Dist. 1999)	9
<i>Lynott v. National Union Fire Ins. Co. of Pittsburgh, Pa.</i> , 123 Wn.2d 678, 871 P.2d 146 (1994)	14, 15
<i>McDaniels v. Carlson</i> , 108 Wn.2d 299, 738 P.2d 254 (1987)	18
<i>Nelson v. Sponberg</i> , 51 Wn.2d 371, 318 P.2d 951 (1957)	4, 5, 6, 7
<i>Northern Pac. Ry. Co. v. National Cylinder Gas Div. of Chemetron Corp.</i> , 2 Wn. App. 338, 467 P.2d 884 (1970).....	9
<i>Tank v. State Farm Fire & Cas. Co.</i> , 105 Wn.2d 381, 715 P.2d 1133 (1986)	9, 10
<i>United Boatbuilders, Inc. v. Tempo Products Co.</i> , 1 Wn. App. 177, 459 P.2d 958 (1969).....	6

I. INTRODUCTION

Newhall/DALD¹ entered into an indemnity agreement that gave Commonwealth—and *only* Commonwealth—the “right to rely upon this Agreement in issuing policies of title insurance with respect to the Land.” CP 7. If Commonwealth issued title policies in reliance upon the indemnity, then Newhall/DALD agreed to indemnify Commonwealth for its losses. *Id.*

After the indemnity was executed, Commonwealth issued a title policy to Chelan Homes. CP 15 (policy with limits of \$2,530,000); CP 20 (supplemental endorsement increasing limits to \$5,830,000). Some years later, Transnation issued multiple title policies to various homeowners with combined limits of \$8,631,566. CP 773. When the Homeowners faced exposure from SBH, Commonwealth and Transnation jointly settled with SBH for \$8,000,000. CP 939-45.

The trial court, finding that the settlement was not the product of “bad faith, collusion and fraud,” saddled

¹ This appeal is now being prosecuted by Bruce Kriegman, in his capacity as the Chapter 7 bankruptcy trustee for the Newhalls.

Newhall/DALD with the entire \$8,000,000 settlement amount. CP 750-51, ¶4 (trial court using tort standards). In so doing, the trial court (1) imported a tort-based “reasonableness” standard into a contractual indemnity case which requires proof of actual damages; (2) concluded that Newhall/DALD were reasonable for Transnation’s share of the settlement obligation even though Transnation was not a party or beneficiary to the indemnity agreement; and (3) refused to permit Newhall/DALD conduct any discovery to determine the proper allocation of the settlement between Commonwealth and Transnation. The trial court erred on all three counts.

II. ARGUMENT

A. ***Moen’s Actual Liability Standard, Not Tort-Based “Reasonableness” Considerations, Controls the Outcome of this Case.***

The parties have a fundamental dispute over whether the trial court used the correct standard in imposing liability upon Newhall/DALD. Commonwealth and Transnation argue that the trial court properly employed a “reasonableness” standard when it entered summary judgment against Newhall/DALD in the amount of the settlement with SBH. See CP 725 (trial court deciding motion

under “reasonableness” standard); CP 750-51, ¶4 (order applying “reasonableness” standard). Newhall/DALD maintain that the tort-based “reasonableness” standard has no place in determining liability under a contractual indemnity clause, and the trial court should have determined whether “actual liability” existed under the indemnity agreement.

Washington law is unambiguous on this dispositive issue. Under controlling authority, the trial court should have considered (1) whether the indemnitee (Commonwealth) was legally liable in the underlying action and, if so, (2) the actual damages the indemnitee would have paid. *Gilbert H. Moen Co. v. Island Steel Erectors, Inc.*, 128 Wn.2d 745, 764, 912 P.2d 472 (1996). The settlement agreement does not determine the extent of Newhall/DALD’s liability, a determination of “actual liability” does:

Under Washington law, an indemnitee who settles does not automatically recover the amount of the settlement from the indemnitor but ***must prove it was in fact liable for the amount of the settlement under the ‘actual liability’ standard.***

Moen, 128 Wn.2d at 764 (emphasis added). The “actual liability” standard in *Moen* is not some anomaly– it has long been the law in Washington that a settlement does not establish the amount owed under an indemnity agreement:

... Washington is with the majority of courts which hold that an indemnitee who seeks reimbursement from his indemnitor for a payment made by him in discharge of a claim indemnified against is not bound to submit to suit before paying the claim; *but if he pays without such suit, as a condition of recovery from his indemnitor, he is under the necessity of proving that he was liable for the amount thus paid.*

Nelson v. Sponberg, 51 Wn.2d 371, 376-77, 318 P.2d 951, 954 (1957).

Commonwealth and Transnation make no attempt to address these clear statements of law by the Washington Supreme Court. Rather, they suggest that *Moen* does not apply because of the supposed breadth of the indemnity clause with Newhall/DALD. Title Insurers’ Br. at 23. But in *Moen*, the indemnity agreement was exceptionally broad, promising indemnification from “any and all claims, demands, losses and liabilities to or by third parties ... connected with, services performed ... [by subcontractor’s] employees to the fullest extent permitted by law” *Id.* The same was true of the common law

indemnity at issue in *Nelson*. *Nelson*, 51 Wn.2d at 374-75 (issue involved indemnity as a matter of law for losses). The breadth of the indemnity does not affect the analytical standard. *Moen* and *Nelson* instruct that under any indemnity agreement, including a broad one, the indemnitee may settle, but it still has the burden of proof of establishing that it was actually liable and the actual amount of damages it would have paid. *Moen*, 128 Wn.2d at 764.

Where an indemnitee waits to pursue its indemnity claims until after an adjudication of its actual liability and damages in the underlying action, determining the extent of liability is easy. In that situation, there is little dispute over the amount of damages. But where, as here, the indemnitee settles before an actual adjudication of liability and damages, the indemnitee is not automatically entitled to its settlement payment. *See, e.g., id.* at 748.

Rather than following the Supreme Court's decision in *Moen* and *Nelson*, Commonwealth and Transnation urge this Court to follow two lower court decisions, which they argue support the trial court's decision only to determine whether the underlying settlement was "reasonable." Title Insurers' Br. at 21; 23 (citing

Cheney v. City of Mountlake Terrace, 20 Wn. App. 854, 863, 583 P.2d 1242 (1978) and *United Boatbuilders, Inc. v. Tempo Products Co.*, 1 Wn. App. 177, 181, 459 P.2d 958 (1969)). Commonwealth and Transnation misunderstand these cases. (Of course, if the cases actually did mean what they assert, then *Cheney* and *United Boatbuilders* would be in direct conflict with the Supreme Court's *Moen* and *Nelson* decisions.)

Neither *Cheney* nor *United Boatbuilders* authorizes the use of a "reasonableness hearing" to determine an indemnitee's liability. To the contrary, *United Boatbuilders* explicitly holds that an indemnitee must prove liability for the actual amount paid in the underlying settlement. *United Boatbuilders*, 1 Wn. App. at 181 (citing to *Nelson*). There, the court held that a settlement ***did not*** establish a right to obtain indemnification without proof of actual liability:

Our Supreme Court has ***never embraced the theory of 'potential liability.'*** It has consistently required an indemnitee, ***if he settles a claim before judgment, to prove that he was in fact liable in damages.***

Id. at 181 (emphasis added). It therefore rejected the plaintiff's attempt to seek recovery under an indemnity agreement for sums it

paid in settlement because it could not prove actual liability or actual damages. *Id.* at 181 (“A review of the findings of the trial court fails to disclose any *actual basis* for liability”) (emphasis added).

Likewise, in *Cheney*, the trial court determined the indemnitee’s *actual damages*, rejecting the amount obtained in settlement of the underlying action. *Cheney*, 20 Wn. App. at 857 (finding that the indemnitee’s actual damages were \$6,220.84, and rejecting the \$10,693.24 settlement amount). The Court of Appeals concurred, finding that the *actual damages, not the settlement amount*, established the indemnitor’s damages in the later indemnity action. *Id.* at 863. When the court used the term “reasonable” in the quotation relied upon by Commonwealth and Transnation, it simply meant that the trial court had previously determined the *actual liability* of the indemnitor. *Id.* at 857, 863. It did not purport to establish a new standard that conflicted with *Nelson*.

Commonwealth, Transnation and the trial court imported “bad faith” insurance principles, which include a “reasonableness

determination," into this indemnity action. See Title Insurers' Br. at 31-33; CP 725; CP 750-51, ¶4. In support of the trial court's approach, Commonwealth and Transnation cite to *Heights at Issaquah Ridge Owners Ass'n v. Derus Wakefield I, LLC*, 145 Wn. App. 698, 187 P.3d 306 (2008) as justification for the use of a "reasonableness" hearing in which the only consideration of damages relates to "the existence of bad faith, collusion and fraud in the settlement agreement." Title Insurers' Br. at 31, 33; CP 750-51, ¶4 (trial court using tort standards).

Heights, however, stands for the unremarkable proposition that a reasonableness hearing must be held when a settlement involves joint tortfeasors or when a settlement may become the measure of damages in *a later bad faith claim against an insurer*. *Id.* at 308-09. The decision simply never addresses the use of an underlying settlement in a later *indemnity* action. As a result, *Heights* is not inconsistent with *Moen*, which plainly rejects a tort-based reasonableness analysis. *Moen*, 128 Wn.2d at 764.

There are, in fact, good reasons to treat indemnity agreements differently from insurance policies:

First, indemnity agreements are governed by contract, not tort principles. *Northern Pac. Ry. Co. v. National Cylinder Gas Div. of Chemetron Corp.*, 2 Wn. App. 338, 342, 467 P.2d 884, 887 (1970). All of the indemnitor's obligations must be determined from the "wording and meaning of the indemnity agreement." *Id.*

Second, indemnity agreements are presumed to have been negotiated between equals, in order to allocate costs or expenses on a predictable basis. *Id.* Indemnity agreements are not insurance where a risk is undertaken in exchange for payment of a premium, nor are the agreements presumed to be contracts of adhesion where one party is the "dominant bargainer." *Heppler v. J.M. Peters Co.*, 87 Cal.Rptr.2d 497, 512-13 (Cal.App. 4 Dist. 1999).

Third, indemnitors are not fiduciaries for their indemnitees. Insurers, on the other hand, have special fiduciary duties to their insureds. *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 385-386, 715 P.2d 1133 (1986). Those duties have lead to the establishment of special rules governing insurers, including the availability of a bad faith claim when an insurer fails to reasonably settle a case on

behalf of an insured. *Id.* No such special duties exist for indemnitors.

The trial court erred by not following the procedure set forth in *Moen*. The tort-based reasonableness standard employed by the trial court has no place in contractual indemnity disputes, and the judgment entered against Newhall/DALD should be reversed, with this case remanded back to the trial court with instructions to determine Newhall/DALD's liability, if any, under the actual liability set forth in *Moen*.

B. The Indemnity Agreement Applies To Commonwealth, But Not Transnation.

Under the actual liability standard, Commonwealth and Transnation were required to prove that they each were covered by the indemnity contract. While Newhall/DALD entered into an agreement with Commonwealth, they did not agree to indemnify Transnation and are not liable for any of Transnation's losses. The trial court's decision to include Transnation as an entity protected by Newhall/DALD's indemnity was error.

First, the plain language of the indemnity agreement reveals that it only applies to policies issued by Commonwealth. *Second*,

Commonwealth drafted the agreement with no changes by Newhall. Thus any ambiguities that exist must be construed against Commonwealth. *Third*, the extrinsic evidence offered by Commonwealth and Transnation of what Newhall/DALD's attorney wrote in 2007 does not shed light on their intent when they signed the agreement in 2004, and should not have been considered. *Fourth*, equitable estoppel does not apply since Commonwealth and Transnation did not rely upon any statement or act from Newhall/DALD that they would pay for their agreement with SBH. In fact, Transnation's losses were the result of writing the title policies to the Homeowner in 2005 and early 2006, not the result of any subsequent act or statement by Newhall/DALD in 2007.

1. The indemnity agreement explicitly applies to only Commonwealth.

The plain language of the indemnity agreement reveals that Commonwealth alone was the intended beneficiary of the agreement. The agreement itself states that it is made for the "benefit and protection of Commonwealth Land Title Insurance

Company.” CP 6. No other intended beneficiary is identified. The language of the agreement could scarcely be more clear.

Transnation relies upon a different section to argue that the agreement applies to any and all subsequent title insurers to the Property. See Title Insurers’ Br. at 38. The section it quotes, however, actually indicates that only the “Company” – defined as Commonwealth, and only Commonwealth—may issue future policies in reliance upon the indemnity:

THE INDEMNITOR FURTHER AGREES that *the Company is hereby granted the right to rely upon this Agreement* in issuing policies of title insurance with respect to the Land, whether or not Indemnitor is the person ordering the same, regardless of any change in ownership, title or interest in the Land, or of any change of Indemnitors’ interest therein. *Said right* shall extend to subsequent policies issued with respect to the Land.

CP 7 (emphasis added). Under a plain reading of the section, the “said right” in the second sentence is a direct reference to the “right” of “the Company” to “rely upon this Agreement” in issuing policies set forth in the preceding sentence. The right to rely is limited. It extends only to “the Company.” And, under the agreement, “the Company” is a defined term: it refers to

“Commonwealth Land Title Insurance Company” and no one else.

CP 6.

The limitation to Commonwealth is further underscored by the agreement use of the word “policies.” Throughout the agreement, the word is to describe policies issued by Commonwealth, not any other insurer. *See e.g.*, CP 6 (“WHEREAS, *the Company* is being requested to issue *its policy(ies) of title insurance* insuring an interest in or title to the real property...”) (emphasis added). The agreement simply never refers to other title insurers or policies issued by other insurers.

The suggestion that Newhall/DALD were undertaking to indemnify any policy from any title insurer in the world—be it Stewart Title, Old Republic, Chicago Title or anyone else—is simply inconsistent with the language of the agreement and common sense. It is also in direct conflict with evidence from Newhall that this was not the intent of the agreement. *See* CP 652 (Newhall never agreed to indemnify any company other than Commonwealth, and would have refused to sign any agreement that purported to extend indemnity to others).

The trial court erred in concluding that Transnation had any right to indemnification simply because it had “relied” upon the Agreement. *See* CP 725-26. Transnation, a third party to the agreement, simply had no contractual or legal right to rely upon the indemnity between Commonwealth and Newhall/DALD in issuing its title policies to the Homeowners.

2. Commonwealth drafted the agreement, so any ambiguities must be construed against it.

Even if the agreement was ambiguous—and it is not—any ambiguities must be construed “strongly against” the drafter, Commonwealth. *Guy Stickney, Inc. v. Underwood*, 67 Wn.2d 824, 827, 410 P.2d 7 (1966). The indemnity agreement was drafted by Commonwealth. No changes were made by Newhall. CP 651, ¶ 4.

3. Extrinsic evidence does not support an extension of the agreement to Transnation.

Transnation argues that extrinsic evidence indicates that Newhall/DALD intended to indemnify it. Title Insurers’ Br. at 36 (*citing Berg v. Hudesman*, 115 Wn.2d 657, 667-68, 801 P.2d 222 (1990)). However, use of extrinsic evidence is very limited. *Id.* A court may not consider extrinsic evidence in order to “add, modify or contradict” the terms of a contract. *Lynott v. National Union Fire*

Ins. Co. of Pittsburgh, Pa., 123 Wn.2d 678, 683, 871 P.2d 146 (1994) (clarifying *Berg*). Admissible extrinsic evidence only relates to the situation of the parties and circumstances *at the time the agreement was executed*. *Id.* The parties' actions years later may be considered only as they bear on their intent at the time the agreement was signed. *Id.* Here, none of the evidence identified by Transnation bears on the question of the parties' intent at the time the agreement was executed. Title Insurers' Br. at 38-39 (citing conduct in 2006 and 2007).

Moreover, the extrinsic evidence cited by Transnation does not even support its position that Newhall/DALD agreed to indemnify it. The communications from Newhall/DALD's attorney cited by Transnation show that Newhall/DALD only agreed to accept Commonwealth's tender. CP 815-16; CP 818. If, in fact, Commonwealth was billing Newhall/DALD for a defense of Transnation insureds, then Newhall/DALD were not aware of this improper use of their defense funds. CP 652-53, ¶¶8, 10-12 (Newhall believed he was only paying fees related to Commonwealth policies); CP 850 (Newhall's attorney believed that

the title policies at issue were “policies that Commonwealth issued”).

Transnation simply misrepresents the evidence to construct its second argument. It argues that “on May 3, 2007 DALD and the Newhalls confirmed in writing to Mr. Kindinger that the Indemnity Agreement extended to the *Transnation* policies and would extend to any subsequent policy issued on the Property.” Title Insurers Br. at 39 (citing CP 849-50) (emphasis added). This appears, based on the representation to the Court, to be compelling evidence in support of their position. The problem, however, is that it is simply not true.

The May 3, 2007 letter does not “confirm” that the agreement extends to Transnation. In fact, the May 3, 2007 letter never even mentions Transnation. CP 849-50. It only acknowledges a duty to defend and indemnify Commonwealth. CP 849 (“the indemnitors extend their indemnity *to Commonwealth* to include subsequent policies that may be issued ...”). Transnation’s misrepresentation otherwise speaks volumes to the quality of its “extrinsic evidence.”

Finally, even if extrinsic evidence were to be considered, it is directly disputed by Newhall's testimony. CP 652-53, ¶¶ 7-9. Summary judgment should not have been entered given such a factual dispute. "Where extrinsic evidence is needed, summary judgment is rarely appropriate." *Hearst Communications, Inc. v. Seattle Times Co.*, 120 Wn. App. 784, 791, 86 P.3d 1194 (2004).

4. Equitable Estoppel does not apply.

Transnation also claims that equitable estoppel prevents Newhall/DALD from asserting that the indemnity agreement did not apply to it. Title Insurers Br. at 39-40. The record fails to show, however, that any of the required grounds for the application of the doctrine exist here.

First, there is no statement or act which could serve to estop Newhall/DALD. Newhall did not even know that Transnation, as opposed to Commonwealth, had issued title policies to the Homeowners. All of the correspondence involving Newhall/DALD indicates that they believed that Commonwealth had insured the Homeowners. CP 815-16, 818, 849-50, 857, 880-98, 900-01, 903-05, 914-15. As shown above, the supposed May 3, 2007

“confirmation” that the indemnity extends to Transnation is flatly inconsistent with the evidence. CP 849-50.

In fact, Transnation never even tendered any claim to Newhall/DALD. CP 815-16. Only Commonwealth tendered. *Id.* Newhall/DALD, in response, only agreed to defend and indemnify Commonwealth. CP 818. Newhall/DALD cannot be estopped when there was no tender, and no agreement of any kind to accept Transnation’s liability.

Second, Transnation does not disclose how any of Newhall/DALD’s actions in 2007 “induced reliance.” *McDaniels v. Carlson*, 108 Wn.2d 299, 308, 738 P.2d 254 (1987). Transnation admits that it issued the policies to the Homeowners in “2005 and early 2006.” Title Insurer’s Br. at 10. Transnation cannot argue that it issued a single title policy in reliance upon any statement made by Newhall/DALD in 2007. And, having already issued the title policies, Transnation never argues that it would have refused to settle with the Homeowners if the indemnity did not extend to it. This destroys the injury prong of estoppel. *Berschauer/Phillips Const. Co. v. Seattle School District No. 1*, 124 Wn.2d 816, 831, 881 P.2d 986 (1994). Transnation’s injury arises from its

2005 and early 2006 issuance of the title policies to the Homeowners, not from any 2007 statement or action by Newhall/DALD.

Third, there can be no reliance because the correspondence makes it clear that Newhall/DALD would resist any indemnity claim that was not based on actual liability or damages. CP 849-50, 903-05. Prior to settlement, Newhall/DALD's attorney indicated, without modifying the terms of the indemnity, that if there were an adjudication regarding actual monetary loss in *SBH v. DALD* that resulted in claims to *Commonwealth's policies*, such claims would be covered by the indemnity agreement. CP 850. Commonwealth was warned, however, that if it entered into a settlement without a determination of actual liability, then it was doing so as volunteer. CP 905 ("... that will not be DALD or Newhall's responsibility."). Transnation cannot now claim reliance when it and Commonwealth were specifically warned that Newhall/DALD would not pay if the matter was settled.

C. There Is A Genuine Issue Of Material Fact Regarding The Exact Amount Of Damages For Which Commonwealth Would Have Been Liable.

If the indemnity agreement does not apply to Transnation, or a genuine issue of material fact exists regarding the agreement's application to Transnation, then reversal is required. Transnation is a necessary link in the connection between the Homeowners' liability (if any) and the indemnity agreement between Commonwealth and Newhall/DALD.

Commonwealth admits that it did not insure title for any of the Homeowners. CP 773, ¶¶ 4-5. The only title Commonwealth insured was Chelan Homes. CP 772, ¶ 2. Thus, if Transnation is not covered by the indemnity agreement, Commonwealth and Transnation must prove coverage under the indemnity in a different way. In this post-settlement context, *Moen* requires an allocation of the settlement amount between the relative exposures of Commonwealth and Transnation.² See, e.g., *Moen*, 128 Wn.2d at 763-64 (directing the trial court to apportion liability on remand, so

² The fact that Commonwealth "paid" \$5 million of the settlement is irrelevant. Under *Moen*, the question is actual exposure, not actual payment. *Moen*, 128 Wn.2d at 763-64.

that the actual liability and damages of the indemnitee could be determined). This allocation is a question of fact, and this matter should be sent back to the trial court to adjudicate that allocation at trial. *Id.*

III. CONCLUSION

Tort-inspired “reasonableness” standards have no place in determining liability under a contractual indemnity agreement. The trial court erred in assessing liability to Newhall/DALD because it determined that the settlement agreement among Commonwealth, Transnation and SBH was not the product of “fraud, bad faith or collusion.” CP 751. Under *Moen*, it was required to determine the actual liability and damages of Commonwealth.

Moreover, the trial court erred when it stretched the indemnity agreement to cover title policies issued by a non-party to the agreement, Transnation. The agreement only extends to Commonwealth, and it was an error to hold otherwise.

Accordingly, the trial court’s orders should be reversed. Specifically, the summary judgment orders and judgments finding

Newhall/DALD liable under the indemnity agreement should be reversed and the matter remanded for trial, with Newhall/DALD permitted to conduct discovery, on all issues.

DATED: May 9, 2011.

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I certify, under penalty of perjury pursuant to the laws of the State of Washington, that on May 9, 2011, a true copy of the foregoing APPELLANTS' OPENING BRIEF was served upon counsel as indicated below:

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