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No. 67036-1-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

CAPITOL SPECIALTY INSURANCE CORPORATION,

Appellant,

v.

YUAN ZHANG,

Respondent.

REPLY BRIEF OF APPELLANT

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TABLE OF CONTENTS

I. SUMMARY OF ARGUMENT.....1

II. ARGUMENT.....3

A. Standard of Review.....3

B. Application of the Glover/Chaussee factors to both settlements.....4

1. The releasing person’s damages.....4

a. The amounts included in the Ready settlement bear no relation to the claims that were settled.....5

i. Ms. Zhang’s out-of-pocket costs.....5

ii. Hawk’s attorney fees.....6

b. The Hawk settlement includes significant costs that cannot be attributed to Hawk’s breach of contract.....7

i. Ms. Zhang was never entitled to the repair of pre-existing damages for free.....8

ii. Ms. Zhang’s repair bid includes several items outside the scope of Hawk’s contract.....9

iii. Ms. Zhang’s repair bid includes multiple upgrades.....10

iv. Ms. Zhang’s repair bid includes at least three costs that were always her responsibility.....10

v. Ms. Zhang’s repair bid is excessive in general.....11

vi. Ms. Zhang failed to establish any diminution in value.....12

vii. Ms. Zhang’s “lost rent” damages are excessive and unsupported.....13

viii. Litigation costs.....14

ix. Attorney fees.....15

2.	The merits of the released person's defense theory....	15
3.	The released person's relative fault.....	18
4.	The risks and expenses of continued litigation.....	19
5.	The released person's ability to pay.....	20
6.	Evidence of bad faith and collusion.....	20
7.	The interest of parties not being released.....	24
III.	CONCLUSION.....	24

TABLE OF AUTHORITIES

Cases

<u>Besel v. Viking Ins. Co.</u> , 146 Wn.2d 730, 49 P.3d 887 (2002).....	2, 21
<u>Bowers v. Transamerica Title Ins. Co.</u> , 100 Wn.2d 581, 675 P.2d 193 (1983).....	15
<u>Chaussee v. Md. Cas. Co.</u> , 60 Wn. App. 504, 803 P.2d 1339 (1991).....	3, 4, 24
<u>Eastlake Constr. Co. v. Hess</u> , 102 Wn.2d 30, 686 P.2d 465 (1984)....	2, 8, 9
<u>Glover v. Tacoma General Hospital</u> , 98 Wn.2d 708, 658 P.2d 1230 (1983).....	3, 4, 24
<u>Heights at Issaquah Ridge Owners Ass’n v. Derus Wakefield I, LLC</u> , 145 Wn. App. 698, 187 P.3d 306 (2008)...	12, 18
<u>Meadow Valley Owners Ass’n v. St. Paul Fire & Marine Ins. Co.</u> , 137 Wn. App. 810, 156 P.3d 240 (2007).....	3
<u>Olympic Steamship Co. v. Centennial Insurance Co.</u> , 117 Wn.2d 37, 811 P.2d 673 (1991).....	14
<u>Panorama Village Condo. Owners Ass’n Bd. of Dirs. v. Allstate Ins. Co.</u> , 144 Wn.2d 130, 142 P.3d 910 (2001).....	14
<u>Panorama Village Homeowners Ass’n v. Golden Rule Roofing, Inc.</u> , 102 Wn. App. 422, 10 P.3d 417 (2000).....	12
<u>Sheng-Yen Lu v. King County</u> , 110 Wn. App. 92 38 P.3d 1040 (2002)....	4
<u>Water’s Edge Homeowner’s Ass’n v. Water’s Edge Associates</u> , 152 Wn. App. 572, 216 P.3d 1110 (2009).....	5, 13, 18, 20, 23, 24
<u>Werlinger v. Warner</u> , 126 Wn. App. 342, 109 P.3d 22 (2005).....	3

Statutes

RCW 4.22.060.....1, 3, 8, 21
RCW 48.30.15.....23
RCW 64.55.....11

I. SUMMARY OF ARGUMENT

The burden was on Ms. Zhang to prove that her settlements with Hawk Construction, LLC (“Hawk”) and Ready Construction, LLC (“Ready”) were reasonable. RCW 4.22.060(1). Ms. Zhang failed to meet this burden because she did not provide an adequate factual or legal response to Capitol’s numerous objections to the settlements.

The settlements were inherently unreasonable because they resulted in Ms. Zhang receiving more through confessed judgments (\$2,381,773; CP 409 & 577) than she had requested in her trial brief (\$2,128,606.72; CP 278-79). Through settlement, Ms. Zhang received not only the cost to fully repair her building but also received: a refund of all money she had paid; forgiveness of sums that were her responsibility under the contract; 12 months of lost rent for repairs scheduled to last 5 months; and more than \$600,000 in attorney fees, including \$140,000 in fees and costs attributable to Hawk’s defense that were never paid by Ms. Zhang or Hawk but were actually paid (in part) by Capitol.

Ms. Zhang claims she discounted the Hawk settlement by 10%, but that claim relies on an inflated base-line of damages such that the settlement remains excessive even after the 10% “discount” is applied. Ms. Zhang does not claim to have applied *any* discount to the Ready settlement.

The central problem with both settlements is Ms. Zhang's failure to use an appropriate measure of damages. With respect to the Ready settlement, Ms. Zhang does not even claim to have used a correct measure of damages but, rather, admits that she used her own out-of-pocket costs plus Hawk's alleged attorney fees as a mere "yardstick to measure Hawk's damages." Response Brief ("Response"), p. 33 (emphasis in original).

As to the Hawk settlement, it includes hundreds of thousands of dollars in "construction costs" that cannot be attributed to Hawk's breach of contract. Most notably, Ms. Zhang offers no justification for the failure of the settlement to reflect her contractual obligation to pay for the repair of pre-existing damages. See Eastlake Constr. Co. v. Hess, 102 Wn.2d 30, 46, 686 P.2d 465 (1984), infra, p. 8. Further, Ms. Zhang offers no response to several problems pointed out in Capitol's Appellant Brief, including \$189,622.19 in fees and taxes that were always Ms. Zhang's responsibility.

The Supreme Court has warned: "a covenant not to execute raises the specter of collusive or fraudulent settlements" because it leaves an insured with little "incentive to minimize the amount of a judgment." Besel v. Viking Ins. Co., 146 Wn.2d 730, 737-38, 49 P.3d 887 (2002). Capitol's Objections to Plaintiff's Reasonableness Motions, CP 773-798, raised several problems with the settlements which suggested that the

negotiations were not arms-length but, rather, were grossly unbalanced and collusive. It was Ms. Zhang's burden to prove that, despite appearances, the settlements were indeed reasonable. She failed to carry this burden, so the settlements should have been rejected as unreasonable.

II. ARGUMENT

A. Standard of Review

A trial court's decision on a Reasonableness Motion is reviewed for abuse of discretion. Werlinger v. Warner, 126 Wn. App. 342, 349, 109 P.3d 22 (2005). The trial court's discretion must be exercised within the boundaries of the law, so *de novo* review applies to the extent the reasonableness determination is based on a question of law. Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co., 137 Wn. App. 810, 816, 156 P.3d 240 (2007).

Plaintiff faults Capitol for failing to "point to a specific error in law or certain material facts that are not supported in the record," Response, p. 36, but the trial court did not issue a written opinion or otherwise explain its ruling. It appears the trial court failed to recognize the burden of proof codified at RCW 4.22.060(1) or, alternatively, sorely misapplied the law – the Glover/Chaussee¹ factors – to the mostly undisputed facts.

¹ Glover v. Tacoma General Hospital, 98 Wn.2d 708, 658 P.2d 1230 (1983); Chaussee v. Md. Cas. Co., 60 Wn. App. 504, 803 P.2d 1339 (1991).

“A trial court abuses its discretion only when its decision is manifestly unreasonable or based on untenable grounds.” Sheng-Yen Lu v. King County, 110 Wn. App. 92, 99, 38 P.3d 1040 (2002). A decision is “manifestly unreasonable” if it is “outside the range of acceptable choices, given the facts and the applicable legal standard.” Id. That is exactly what occurred here: the trial court approved settlements that, among other things, used an admittedly wrong measure of damages (Ready) and ignored the undisputed fact that Ms. Zhang was required to pay for the repair of pre-existing damage (Hawk).

A trial court’s decision “is based on untenable reasons if it is based on an incorrect standard or the facts do not meet the requirements of the correct standard.” Id. Here, it appears that the trial court either did not apply the proper burden of proof or, instead, erred by finding that Ms. Zhang adequately supported the amount of damages included in the settlements. Accordingly, the trial court’s decisions should be reversed.

B. Application of the Glover/Chaussee factors to both settlements.

The following discussion of the Glover/Chaussee factors applies equally to both settlements, except with respect to the first and third factors, below.

1. The Releasing Person’s Damages

We begin with the Ready settlement, as its flaws are the most

obvious.

- a. The amounts included in the Ready settlement bear no relation to the claims that were settled.

The Ready settlement consists of Ms. Zhang's out-of-pocket costs plus Hawk's alleged defense costs. Response, p. 32. As shown below, there is no legal or factual support for either item of damages.

- i. *Ms. Zhang's out-of-pocket costs*

The Ready settlement is based on a measure of damages (Ms. Zhang's out-of-pocket costs) that bears no relation to the claims actually settled. The Response concedes so much but defends on the basis that Ms. Zhang's out-of-pocket costs served as a "yardstick" for the actual damages sustained by Hawk. Response, p. 33. However, both of Hawk's claims alleged generally that Ready was liable to Hawk to the extent Hawk was liable to Ms. Zhang. CP 21-22. Because Ms. Zhang neither sought nor recovered "out-of-pocket" costs, Hawk could never recover these same costs from Ready. The Response offers no explanation or authority for how Hawk could recover costs it never incurred. Because the Ready settlement was based on an incorrect measure of damages, it should have been rejected as unreasonable. Water's Edge Homeowner's Ass'n v. Water's Edge Assocs., 152 Wn. App. 572, 587, 216 P.3d 1110 (2009).

Further, Ms. Zhang failed to support the \$380,000 in alleged "out-

of-pocket” costs. Appellant’s Brief, pp. 38-39, pointed out multiple problems with the invoices Ms. Zhang submitted, including: (1) duplicative invoices; (2) dates that do not match with Ms. Zhang’s claim that these costs were incurred “for the Phase 1 repairs”², CP 577; and (3) charges that were previously refunded to Ms. Zhang. The Response offers no rebuttal on these issues.

ii. Hawk’s attorney fees

The inclusion of Hawk’s attorney fees in the Ready settlement is troubling for several reasons. Most notably, Hawk did not incur any attorney fees, as Ms. Zhang admits that “it appears Capitol fulfilled its obligation to defend Hawk.” CP 925. Ms. Zhang argues that it was appropriate to include fees Hawk never incurred because of the possibility that Capitol would seek reimbursement of such fees “as part of its action for declaratory judgment.” Response, p. 33. However, there was no declaratory judgment action at the time of the settlement, see CP 1015 (noting, in March of 2011, that the action had been “recently filed”), and speculation about a potential, future claim by Capitol is insufficient to convert the attorney fees paid by Capitol into “damages” sustained by Hawk. Plus, Hawk does not have any assets, see p. 20, below, so Capitol

² The Response Brief appears to backtrack on this issue. Pages 32 and 33 of the Response once describe the \$380,000 as “Construction Costs for Phase 1” but twice reference Phase 1 and Phase 2 when discussing the same costs.

would have no motivation to seek reimbursement from Hawk.

Particularly troubling is the inclusion of \$45,132.47 in attorney fees allegedly incurred by Ms. Zhang's own attorneys on behalf of Ms. Zhang as Hawk's assignee. There was, at most, a couple-day period between the assignment and the Ready settlement, see CP 576 (Hawk settlement on November 19); CP 577 (Ready settlement on November 17), and Ms. Zhang offers no explanation as to how she could have incurred over \$45,000 in fees in that time. Rather, as the invoices she submitted to the trial court (CP 1021-1027) prove, Ms. Zhang is actually attempting to recover tens of thousands of dollars in attorney fees incurred *after* the Ready settlement, including fees that are plainly not attributable to Hawk's defense but are attributable instead to Ms. Zhang's preparation for anticipated coverage litigation (see, e.g., CP 1025: "Research policies and claims stemming from Ready policies") and/or attributable to Ms. Zhang's efforts to set-up Capitol for a bad faith claim (see, e.g., CP 1027: "Preparation of a series of IFCA notice letters...", referring to the libelous letters discussed in Appellant's Brief at p. 34). The Response offers no justification for including these fees in the Ready settlement.

- b. The Hawk settlement includes significant costs that cannot be attributed to Hawk's breach of contract.

This Reply Brief addresses each of the sub-points raised in

Appellant's Brief, in order:

- i. *Ms. Zhang was never entitled to the repair of pre-existing damages for free.*

Ms. Zhang's Response does not dispute the fact that both Hawk's repair estimate and her own included costs attributable to damage that pre-existed Hawk's contract. CP 838 ("This scope of repair also addresses replacement of known decayed wall and deck sheathing that was supposed to be removed and replaced by Hawk Construction, but was not."); CP 849 (same). It is also undisputed that "Ms. Zhang contracted with Hawk on a time and material basis to repair [pre-existing] damage." Response, p. 16.

Because the plaintiff in a breach of contract action must deduct from its damages "any cost or other loss that he has avoided by not having to perform," Eastlake Constr., 102 Wn.2d at 46, it was incumbent upon Ms. Zhang – who bore the burden of proof, RCW 4.22.060(1) – to provide the court with some evidence upon which to base a calculation of the necessary deduction. Ms. Zhang has offered neither any evidence nor any justification for her apparent position that no deduction is required despite the Eastlake rule.

Capitol presented the only evidence on this topic, being the declaration of its expert. After reviewing "numerous photos, deposition transcripts, reports and other documents related to the Lake City

Apartments,” Mr. Lawless opined that 80% of the damage found at The Apartments pre-existed Hawk’s contract with Ms. Zhang. CP 800 at ¶ 2; 802 at ¶ 7. Mr. Lawless concluded that \$147,879.70 of the costs included in Ms. Zhang’s estimate were attributable to the repair of pre-existing damages. CP 801 at ¶ 4(f).

While Ms. Zhang’s expert may disagree with Mr. Lawless regarding the cause of pre-existing damages, the *causation* of the pre-existing damages is not relevant. All parties agree that at least some damages pre-existed Hawk’s contract. CP 838. Therefore, at least some deduction must be applied pursuant to Eastlake to reflect the amounts Ms. Zhang would have been required to pay Hawk if Hawk had repaired the pre-existing damage consistent with its contractual obligations. Because the Hawk settlement failed to apply *any* discount with respect to this issue, it should have been rejected as unreasonable.

ii. Ms. Zhang’s repair bid includes several items outside the scope of Hawk’s contract.

The Response, p. 17, argues that new door pans and repairs to the “rim joists and headers for the decks” are necessary for a complete repair, but Ms. Zhang does not offer any explanation for why this work is chargeable to Hawk. For example, there is no indication that the joist and header work is required due to Hawk’s breach rather than to pre-existing

damage. The scope of work in Hawk's contract was likely too narrow in the first place. See CP 803, ¶ 8 (Mr. Lawless's discussion). Ms. Zhang cannot now correct her initial mistake by including additional items in her settlement with Hawk.

iii. Ms. Zhang's repair bid includes multiple upgrades.

The Response, p. 17, admits that the "construction costs" component of the Hawk settlement includes money for at least two upgrades: cedar deck fascias and a second layer of building paper. Although Ms. Zhang dismisses the upgrades as insignificant, she does not offer any legal justification for including them in her settlement calculations without *any* associated discount.

iv. Ms. Zhang's repair bid includes at least three costs that were always her responsibility.

The Response offers no explanation for why the Hawk settlement includes \$189,622.19 in additional sales tax and architectural and engineering fees that were always Ms. Zhang's responsibility. See, Appellant's Brief, pp. 16-17. With respect to \$53,184 attributable to temporary protection of the building, id., p. 18, Ms. Zhang responds that even though she may have been required to pay for temporary protection, "it was Hawk's responsibility to request and install it." Response, p. 4.

However, the contract plainly assigned “the costs and responsibility” for temporary protection to Ms. Zhang. CP 830-31 (emphasis added).

Because Ms. Zhang lacks a sufficient explanation for any of these costs, the Hawk settlement should have been rejected as unreasonable.

v. *Ms. Zhang’s repair bid is excessive in general.*

Ms. Zhang argues that “[t]he \$1,224,471 agreed to by the parties for construction repairs was within 10 percent of their respective repair costs.” Response Brief, p. 13. However, Hawk’s expert estimated construction costs at \$887,693, CP 471, which is \$336,578, or 27.5%, less than Ms. Zhang’s estimate. The \$1,224,471 figure is the exact amount of Ms. Zhang’s estimate. CP 489. It does not reflect *any* compromise.

In order to support her 10% claim, Ms. Zhang adds \$100,000 to Hawk’s estimate for RCW 64.55 compliance, citing her expert’s declaration, CP 772, in support. Response, p. 19. However, Ms. Zhang’s expert placed the “total” cost for “Architectural and Engineering services and RCW 64.55 testing” at \$118,021.38. CP 772 (emphasis added).

Architectural and engineering services were always Ms. Zhang’s responsibility, CP 99, and there is no evidence in the record of the cost of RCW 64.55 testing by itself, being the only cost allegedly omitted from Hawk’s estimate. There is no basis, then, for adding \$100,000 to Hawk’s

estimate in order to make the parties' positions appear artificially closer.

Ms. Zhang also relies on an overall 10% "discount" applied to the Hawk settlement. However, that "discount" assumed that her repair estimate, which exceeds Hawk's by 27.5%, represents the reasonable cost of repair. The "discount" also relies on an inflated base-line of damages that resulted in Ms. Zhang receiving more through settlement than she requested in her trial brief, even after the 10% "discount" is applied. See Appellant's Brief, pp. 18-19.

Even if the 10% "discount" were a true discount, it is significantly smaller than the 17.5% discount found reasonable in Heights at Issaquah Ridge Owners Ass'n v. Derus Wakefield I, LLC, 145 Wn. App. 698, 706, 187 P.3d 306 (2008). Especially when the Court considers the other problems with Ms. Zhang's "construction costs" figure – including over \$390,000 in costs attributable to the repair of pre-existing damages or to architectural fees and other costs that were always Ms. Zhang's responsibility – it is apparent that the Hawk settlement did not include any real compromise or discount on the issue of "construction costs."

vi. Ms. Zhang failed to establish any diminution in value.

Citing Panorama Village Homeowners Ass'n v. Golden Rule Roofing, Inc., 102 Wn. App. 422, 428, 10 P.3d 417 (2000), Ms. Zhang

argues that it was Capitol's burden to prove the amount of any diminution in value. However, Capitol carried its burden by pointing out that Ms. Zhang is in substantially the same position today as she was prior to her contract with Hawk – The Apartments still need to be re-sided and damage that pre-existed Hawk's work still needs to be repaired. CP 838, 845.

Capitol's expert estimated that only \$383,449.29 of Ms. Zhang's "construction costs" were actually attributable to Hawk's defective work. CP 802, ¶ 6. In other words, it will now cost Ms. Zhang approximately \$385,000 more than it should have to bring The Apartments into good condition. Thus, Hawk's breach caused a diminution in value of only \$385,000, which is clearly disproportionate to Ms. Zhang's claimed repair costs of \$1,224,471. Because Ms. Zhang failed to offer any diminution in value calculations of her own, the Hawk settlement should have been rejected as unreasonable. Water's Edge, 152 Wn. App. at 587.

vii. Ms. Zhang's "lost rent" damages are excessive and unsupported.

The Hawk settlement is unreasonable because it includes 12 months in "lost rent" for repairs scheduled to last only 5 months. Appellant's Brief, pp. 21-22. The Response, pp. 21-22, justifies the additional charges by pointing out that Ms. Zhang's tenants "endured ongoing construction" during Hawk's original work. However, Ms.

Zhang did not bargain for “lost rent” compensation during Hawk’s original work, so she can only charge Hawk for “lost rent” during the 5 months it will take to remedy Hawk’s alleged breach of contract.

Similarly, the Response, pp. 21-22, attempts to justify the additional charges by claiming that “repairs are on hold for the appeal process and Capitol’s declaratory action.” However, there is no explanation for why Hawk should be charged with “lost rent” damages allegedly attributable to Capitol. Moreover, Capitol’s appeal and coverage action have no bearing on the reasonableness of the Hawk settlement, because neither the appeal nor the coverage action existed at the time of the settlement. See, Response, p. 15 (agreeing this is the standard).

viii. Litigation costs

Ms. Zhang relies on Panorama Vill. Condo. Owners Ass'n Bd. of Dirs. v. Allstate Ins. Co., 144 Wn.2d 130, 142, 26 P.3d 910 (2001), to support her inclusion of expert fees in the Hawk settlement, but Panorama is not on point. That case discussed costs recoverable under Olympic Steamship Co. v. Centennial Insurance Co., 117 Wn.2d 37, 811 P.2d 673 (1991), and not pursuant to, as here, a contract. Moreover, Panorama relied on the phrase “reasonable attorney fees,” 144 Wn.2d at 142, while the contract here referred simply to “attorneys fees and costs.” CP 834, ¶ 18. There is no indication the parties intended to expand the category of

costs generally recoverable under Washington law.

ix. Attorney fees

With respect to the inclusion of \$495,319.68 in attorney fees in the Hawk settlement, Ms. Zhang responds that “counsel for Ms. Zhang had a significant amount of billable hours on this file to justify its contingency fee.” Response, p. 23. However, the amount of fees reflected by the billable hours totals only \$306,853.75. Thus, Ms. Zhang seeks an unreasonable mark-up of 61%. Cf. Bowers v. Transamerica Title Ins. Co., 100 Wn.2d 581, 601, 675 P.2d 193 (1983) (upholding a 50% mark-up).

Ms. Zhang offers no explanation for why her “base” fees exceeded \$300,000, while Hawk’s defense fees barely reached one-quarter of that amount. CP 720. Ms. Zhang does not even attempt to support her requested fees against the factors discussed by Washington courts. See, e.g., Bowers, 100 Wn. 2d at 597-601 (discussing various factors). Because the record does not contain adequate support for a fee award of nearly \$500,000, the Hawk settlement was unreasonable.

2. Merits of the released person’s defense theory

The settlements are unreasonable because they fail to give Hawk or Ready any credit for their defenses. In addition to contesting the amount of damages, Hawk and Ready also intended to defend on the grounds that: (1) “plaintiff withheld pertinent information from Hawk concerning the

condition of the building ...directly impacting the anticipated scope of work”; and (2) “Hawk / Ready’s work was completed at the direction of a construction manager hired by plaintiff, who also inspected and accepted the work as performed.” CP 280, 286; 403.

With respect to the first defense, Ms. Zhang has never offered any explanation for failing to provide her pre-purchase report to Hawk. Instead, she defends on the basis that, despite Capitol’s arguments, the report actually revealed that the Apartments were “in fair condition and only a few repairs away from being in good condition.” Response, p. 2. The report actually says, among other things:

- “It is important that [an] invasive inspection be done prior to purchase of this building due to the large spectrum of possible problems that this building may have due to the vast amount of differed maintenance of the building envelope. There clearly will be a lot of rot that we cannot see, however, for contractor to provide somewhat of an accurate estimate for repairs that are needed, they will have to have a better idea of their scope of work.” CP 298 § 2 (emphasis added).
- “The balconies and wood railings surrounding this building are generally in very poor condition with a vast amount of wood rot and moisture staining visible.” CP 309 § 10.4.
- “A complete renovation of the exterior balconies and resurfacing of the flat roofs will bring this building into good condition.” CP 312, § 14 (emphasis added).

Hawk’s and Ready’s defense based on the pre-purchase inspection report would likely have led to a defense verdict or a steeply discounted award of

damages if the jury believed that Ms. Zhang had misled Hawk and Ready. Accordingly, a discount should have been applied.

With respect to the second defense, Ms. Zhang claims that her “construction professionals,” CP 275, did not supervise or direct the work in any material way. Mr. Amegatcher, she contends, was only hired to “confirm Hawk and Ready showed up on a consistent basis.” Response, p. 6. However, Ms. Zhang does not explain why she needed a “construction professional” to monitor attendance. Moreover, the Response ignores significant evidence that contradicts Ms. Zhang’s position, including: (1) the testimony of Hawk’s principal that “[t]here was” a project supervisor, CP 754, p. 62, see also, CP 755, p. 66 (when asked whether he was “in charge” of the Phase 2 work, Hawk’s principal responded, “When you say ‘in charge,’ what do you mean?”); and (2) a Steelhead Construction invoice, totaling \$15,855.84, for, among other things, “Coordination & Supervision.” CP 826.

Likewise, the record does not support the claim that Hawk was “aware that Ms. Zhang had very little or no construction experience and was completely relying on Hawk to make any decisions affecting the work.” Response, p. 4. Hawk specifically denied such knowledge at his deposition. CP 742 at p. 13, ln 13-15 (“And at the time Hawk entered a contract with Yuan, did [Hawk] realize that she didn’t know much about

construction? A. At the time I didn't know.”).

While the Response raises questions as to the exact roles played by Mr. Amegatcher and Steelhead, it is clear that Hawk and Ready intended to pursue a defense based on their involvement. How a jury would have resolved the defenses is unknown, but that is exactly why the settlements should have given Hawk and Ready at least some credit for this factor.

3. The released person's relative fault

The Response, p. 25, cites Heights at Issaquah Ridge, 145 Wn. App. at 703, and Water's Edge, 152 Wn. App. at 587, for the proposition that “[t]he trial court does not typically consider parties' relative faults to determine the reasonableness of a settlement arising out of a breach of contract claim.” However, the Hawk settlement is the precise type of situation in which this factor applies. See, Water's Edge, 152 Wn. App. at 591 (“The trial court noted that this factor applies when the trial court is determining the reasonableness of a settlement between one or more codefendants with a plaintiff...”).

The Hawk settlement valued Hawk's claims against Ready (which were assigned to Ms. Zhang) at \$0. The Response, pp. 25-26, argues that Ms. Zhang could not assign any value to these claims because, at the time of the settlement, Ms. Zhang lacked the necessary information to definitively value the claims. However, Ms. Zhang based the Ready

settlement on her *own* out-of-pocket costs, so she possessed the relevant information at all times. Ms. Zhang lacks any valid excuse for failing to give Hawk *any* credit for the assigned claims. Thus, the Hawk settlement should have been rejected as unreasonable.

4. The risks and expenses of continued litigation

It is undisputed that both Hawk and Ready were defended by their insurers. CP 925, CP 927. Therefore, it would not have cost either entity any money to proceed to trial. Further, it is undisputed that both Hawk and Ready were inactive companies with no assets at the time of settlement, see Response, pp. 27, 34, so neither company faced any real risk if the matter proceeded to trial. On the other hand, by settling, Ms. Zhang both saved money and recovered *more* than she had requested in her trial brief. Cf. CP 509 and CP 566 (confessed judgments totaling \$2,381,773) with CP 278 (Trial Brief requested \$2,128,606.72).

With respect to Hawk, Ms. Zhang fails to address this issue in any substantive way, instead using this section of the Response to further argue that she was not required to give Hawk any credit for assignment of the Ready claims. Response, p. 26. With respect to Ready, Ms. Zhang argues that “an inactive corporation is not immune from being sued,” and Ready faced real exposure because Capitol was defending pursuant to a reservation of rights. Id., pp. 34-35. However, because Ready had ceased

conducting business and had no assets, it had nothing to lose regardless of the trial outcome and regardless of whether insurance coverage was available. Because the settlements failed to account for this factor, they should have been rejected as unreasonable.

5. The released person's ability to pay

At the time the lawsuit was filed, both Hawk and Ready were inactive limited liability companies with no ability to pay any judgment or settlement. See CP 921 at 10:4-8 (Hawk “closed” in 2008 due to tax problems); CP 926 (Ready inactive as of March, 2009). In response, Ms. Zhang argues that Hawk’s and Ready’s inactive status is irrelevant because a limited liability company may be sued up to three years after dissolution. However, whether or not an entity can be sued has no bearing on whether that same entity has any ability to pay. The settlements were unreasonable because they did not reflect the fact that Hawk and Ready, while properly subject to suit, lacked any ability to pay.

6. Evidence of bad faith and collusion

The test under this factor is not whether Capitol can prove actual fraud but whether, e.g., the settlement’s “overall structure” reflects “a joint effort to create, in a nonadversarial atmosphere, a resolution beneficial to both parties, yet highly prejudicial” to Capitol. Water’s Edge, 152 Wn. App. at 595. Settlements involving covenant judgments, like here, raise

“the specter of collusive or fraudulent settlements.” Besel, 146 Wn.2d at 737-38. Thus, and pursuant to RCW 4.22.060(1), it was Ms. Zhang’s burden to prove that the settlements were reasonable rather than products of bad faith or collusion.

Against this legal backdrop, Capitol pointed out several components of the settlements that are consistent with collusion or bad faith rather than arms-length negotiations, including:

1. Covenant judgments exceeding the amount sought in Ms. Zhang’s trial brief. See, p. 1.
2. An admittedly wrong measure of damages for the Ready settlement. See, p. 5.
3. “Construction costs” that include over \$390,000 in costs attributable to the repair of pre-existing damages or to architectural fees and other costs that were always Ms. Zhang’s responsibility. See, pp. 8-12.
4. Over \$600,000 in attorney fees, including: (a) \$140,000 in fees and costs attributable to Hawk’s defense that were never paid by Ms. Zhang or Hawk but were actually paid (in large part) by Capitol; (b) fees for drafting libelous letters about Capitol and for other tasks related to Ms. Zhang’s effort to set-up Capitol for coverage litigation. See, pp. 6-7.

5. Allocation of damages to siding defects rather than to deck defects in order to affect the anticipated coverage litigation. See, Appellant's Brief, pp. 31-32.
6. Twelve months of "lost rent" for five months of repairs. See, pp. 13-14.
7. No discount in recognition of the unbalanced costs and risks of litigation. See, pp. 19-20.
8. No discount in recognition of Hawk's and Ready's inability to pay. See, p. 20.
9. No credit to Hawk for assignment of its claims against Ready. See, pp. 18-19.
10. No credit for Hawk's and Ready's liability and damages defenses. See, pp. 15-18.

Ms. Zhang failed to credibly rebut any of the above points or to otherwise prove that, despite appearances, the settlements were indeed reasonable.

Ms. Zhang attempts to support the Hawk settlement by arguing that she and Hawk "settled on repair damages that were approximately 10 percent apart according to their experts." Response, p. 29. However, as discussed above, see pp. 11-12, the parties' estimates actually differed by 27.5%; and the overall, 10% discount Ms. Zhang relies upon is illusory because it is: (a) taken from an inflated baseline of damages exceeding

what she requested in her trial brief; and (b) calculated from a repair estimate that does not include any deduction for costs that cannot be attributed to Hawk's breach of contract (e.g., architectural and engineering fees or costs attributable to the repair of pre-existing damage).

The Response, p. 29, argues that this case is distinguishable from Water's Edge because the parties here did not engage in the same type of "questionable behavior". Yet, Ms. Zhang did send aggressive, libelous letters to the Insurance Commissioner in an attempt to trigger treble damages under RCW 48.30.15. CP 924; CP 927. Although Ms. Zhang eventually retracted the letters, she has never offered any justification for sending them in the first place, suggesting a strategy to "set-up" Capitol, just like in Water's Edge.

Finally, Ms. Zhang misstates the record when she argues that Hawk's and Ready's insurance applications could not be evidence of collusion or bad faith because the applications were "actually filled out by [Capitol's] agent, McFall General Agency, Inc." Response, pp. 30, 35. The record reveals that the applications were signed both by Hawk's and Ready's principals and by "Patrick Moon (PIA)". CP 816, 821. "PIA" is a reference to Hawk's and Ready's agent, Pacific Insurance Agency, as revealed by the notation on the top of each page. Id. Only after the applications were completed by Hawk, Ready and/or their agent, were

they then sent to and “rec’d” by Capitol’s agent, McFall, as shown by the stamps on each page of the applications. *Id.* Thus, this entire matter has been marred by fraud, bad faith and/or collusion from the beginning. Accordingly, the settlements should have been rejected as unreasonable.

7. The interest of the parties not being released

Ms. Zhang contends that Capitol’s interests were adequately considered because “Capitol had an unfettered right to intervene at the reasonableness hearings.” Response, pp 30-31, 35. However, a nearly identical argument was rejected in Water’s Edge, where the settling plaintiff noted that the insurer “had ‘every opportunity to participate’”. 152 Wn. App. at 592. Here, as in Water’s Edge, Capitol was not given any seat at the negotiating table where the amount of the consent judgments was determined. *Id.*, at 593. As demonstrated by the above analysis of the Glover/Chaussee factors, the negotiating parties had no motivation to protect Capitol’s interests but, rather, crafted the settlement for the specific purpose of prejudicing Capitol in the subsequent coverage fight. Because Capitol’s interests were not considered, the settlements should have been rejected as unreasonable.

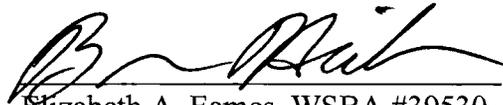
CONCLUSION

For all of the above reasons, Ms. Zhang’s settlements with Hawk and Ready should have been rejected as unreasonable. Capitol

respectfully requests that this Court vacate both reasonableness orders.

DATED this 27th day of December, 2011.

GORDON & POLSCER, L.L.C.

A handwritten signature in black ink, appearing to read "Elizabeth A. Eames", written over a horizontal line.

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CERTIFICATE OF SERVICE

I, Brian C. Hickman, declare as follows:

1) I am a citizen of the United States and a resident of the State of Oregon. I am over the age of 18 years and not a party to the within entitled cause. I am employed by the law firm of Gordon & Polscer, L.L.C., whose address is 9755 SW Barnes Road, Suite 650, Portland, Oregon 97225.

2) By the end of the business day on December 27, 2011, I caused to be mailed to counsel of record at the addresses, postage prepaid, and in the manner described below, the following documents:

- **REPLY BRIEF OF APPELLANT**

Todd Skoglund
Casey & Skoglund
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Seattle, WA 98119

Counsel for Respondent: Yuan Zhang

- U.S. Mail
- Hand Delivery
- Telefax
- UPS
- E-mail

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 27th day of December, 2011.



Brian C. Hickman
Of Attorneys for Appellant