

67663-6

67663-6

NO. 67663-6-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

BOND SAFEGUARD INSURANCE COMPANY, a foreign corporation,

Respondent/Appellee,

vs.

WISTERIA CORPORATION, et. al.,

Petitioners/Appellants.

BOND SAFEGUARD'S RESPONSIVE BRIEF

Alexander Friedrich, WSBA #6144
Paul Friedrich WSBA #43080
Attorneys for Bond Safeguard

YUSEN & FRIEDRICH
Attorneys at Law
215 NE 40th Street, Suite C-3
Seattle, WA 98105-6567
Telephone: (206) 545-2123
Fascimile: (206) 545-6828

FILED
COURT OF APPEALS, DIVISION I
STATE OF WASHINGTON
2012 JUN 25 PM 2:02

TABLE OF CONTENTS

I. INTRODUCTION.....1

II. STATEMENT OF THE CASE.....3

A. Background Facts.....3

B. The Indemnity Agreement.....4

C. Wombat Timber Sale Contract.....5

D. Timber Pole Timber Sale Contract.....8

III. LEGAL ARGUMENT.....11

A. Standard of review.....11

B. The Trial Court properly granted Bond Safeguard’s Motion for Summary Judgment and denied Wisteria’s Motion for Reconsideration.....11

1. Bond Safeguard has a contractual right to settle claims to protect itself.....14

2. Bond Safeguard has a contractual right to settle claims and seek indemnity despite the fact that Wisteria may have had defenses to DNR’s claim.....15

3. Bond Safeguard has a contractual right to settle claims over Wisteria’s objection.....15

4. Because Bond Safeguard settled DNR’s claims in good faith, the Trial Court properly granted Bond Safeguard’s Motion for Summary Judgment.....16

C. The Court should adopt the majority rule governing a surety’s right to indemnity and reject the minority rule advocated by Wisteria.....17

1. Wisteria’s argument that the Court should adopt the reasonableness standard relies on the illogical notion that Washington’s insurance regulations are intended to protect the principal under a surety bond.....20

D. Even if this Court adopts the reasonableness standard, as opposed to the good faith standard, summary judgment was still proper.....23

E. There is no evidence that Bond Safeguard’s investigation was not in good faith or unreasonable.....25

F. Washington’s insurance regulations are intended to protect first party claimants under a policy of insurance and offer no protection to the principal under a surety bond.....27

G. Motion to Strike.....29

H. Bond Safeguard is entitled to an award of attorney’s fees and costs on appeal.....29

IV. CONCLUSION.....30

TABLE OF AUTHORITIES

Cases

<i>City of Portland v. Ward & Associates, Inc.</i> , 89 Or.App. 452, 750 P.2d 171 (1988).....	23, 24
<i>Commercial Ins. Co. of Newark, N.J. v. Pac./Peru Constr.</i> , 558 F.2d 948 (9 th Cir.1977).....	12, 13, 15
<i>Davies v. Holy Family Hosp.</i> , 144 Wn.App. 483, 183 P.3d 283 (2006).....	11
<i>Dussault ex rel. Walker-Van Buren v. American Intern. Group, Inc.</i> , 123 Wn.App. 863, 99 P.3d 1256 (2004).....	22
<i>Employers Ins. of Wausau v. Able Green, Inc.</i> , 749 F.Supp. 1100, (S.D.Fla. 1990).....	17
<i>Engbrock v. Federal Ins. Co.</i> , 370 F.2d 784 (5 th Cir. 1967).....	16, 17
<i>Fid. & Deposit Co. of Md. v. Bristol & Steel Iron Works</i> , 722 F.2d 1160 (4 th Cir. 1983).....	14, 16
<i>Fireman's Ins. Co. of Newark, N.J. v. Todesca Equipment Co., Inc.</i> , 310 F.3d 32 (1st Cir. 2002).....	17
<i>General Acc. Ins. Co. of America v. Merritt-Meridian Const. Corp.</i> , 975 F.Supp. 511 (1997).....	15, 19, 20
<i>Halleran v. Nu W., Inc.</i> , 123 Wn.App. 701, 98 P.3d 52 (2004).....	11
Hinchey, John W., <i>Surety's Performance Over Protests of Principal: Considerations and Risks</i> , 22 Tort & Ins. L.J. 133 (Fall 1986).....	19
<i>Liberty Mut. Ins. Co. v. Aventura Eng'g & Const. Corp.</i> , 534 F. Supp. 2d 1290 (S.D. Fla. 2008).....	16, 30
<i>Nat'l Surety Co. v. Fulton</i> , 183 N.Y.S. 237, 192 A.D. 645 (1920).....	20

<i>PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.</i> , 267 Conn. 279 (2004).....	17, 18
<i>Showalter v. Wild Oats</i> , 124 Wash.App. 506, 101 P.3d 86 (2004).....	11
<i>Tank v. State Farm Fire & Cas. Co.</i> , 105 Wn.2d 381, 715 P.2d 1133 (1986).....	22, 23
<i>Transamerica Ins. Co. v. Bloomfield</i> , 401 F.2d 357 (6 th Cir. 1968).....	16, 20
<i>U.S. Fid. & Guar. Co. v. Feibus</i> , 15 F. Supp. 2d 579 (M.D. Pa. 1998), aff'd 185 F.3d 864 (3rd Cir. 1999).....	11, 12, 13, 17, 30
 Washington Statutes	
RCW 48.30.....	20, 21, 22
 Washington State Court Rules	
Civil Rule 56(c).....	11
 Washington Administrative Code	
WAC 284-30.....	20, 21, 22
 Rules of Appellate Procedure	
RAP 14.2.....	29
RAP 18.1.....	29

I. INTRODUCTION

This appeal arises from Plaintiff Bond Safeguard's claim for indemnity against Defendants Chris Hatch, Stacie Hatch, and Wisteria Corporation (collectively "Wisteria"). Not long after filing its Complaint, Bond Safeguard moved for summary judgment seeking to enforce the reimbursement provisions of the Indemnity Agreement. The trial court granted Bond Safeguard's motion and entered judgment against Wisteria in the total amount of \$75,865.46. *CP 98-100*. The trial court denied Wisteria's subsequent motion for reconsideration and entered a supplemental judgment against Wisteria to reflect additional attorney's fees and costs incurred by Bond Safeguard in enforcing the Indemnity Agreement. *CP 12-13*. On appeal, Wisteria argues that the trial court erred in granting Bond Safeguard's Motion for Summary Judgment and in denying Wisteria's subsequent Motion for Reconsideration.

As a preliminary matter, Bond Safeguard strongly objects to Wisteria's Assignments of Error as they materially misstate the trial court's rulings in this matter. *CP 98-100; CP 12-13*. The Assignments of Error contained in Wisteria's Opening Brief recite findings of fact found nowhere in the trial court record and nowhere in any order or judgments entered by the trial court. In fact, the Court did not make any express written findings in this matter. The trial court simply granted Bond

Safeguard's Motion for Summary Judgment on its claim for indemnity and denied Wisteria's Motion for Reconsideration. *CP 98-100; CP 12-13* Accordingly, the issues on appeal should be strictly limited to whether the trial court properly granted Bond Safeguard's Motion for Summary Judgment and whether the trial court properly denied Wisteria's Motion for Reconsideration.

Wisteria's argument on appeal is best summarized as follows: the trial court erred in failing to apply a reasonableness standard rather than a good faith standard to Bond Safeguard's indemnity claim and that had the trial court correctly applied a reasonableness standard, the trial court would have denied Bond Safeguard's Motion for Summary Judgment because there were material issues of fact as to whether Bond Safeguard reasonably settled the Washington State Department of Natural Resources' ("DNR") claim against the payment and performance bonds.

Wisteria's assignments of error miss the mark. Not only did the trial court properly decline to apply a reasonableness standard, but even if the trial court were to apply a reasonableness standard, there are no material issues of fact as to whether Bond Safeguard acted reasonably and, thus, the trial court properly granted Bond Safeguard's Motion for Summary Judgment and denied Wisteria's Motion for Reconsideration.

II. STATEMENT OF THE CASE

A. Background Facts

This matter arises out of two timber sale contracts between Wisteria and DNR. *CP 248*. The timber sale contracts permitted Wisteria to purchase, cut, and remove certain timber by a fixed date and under certain conditions. *Id.* DNR required Wisteria to obtain payment and performance bonds for each contract. *Id.* The bonds would serve as a financial guaranty that Wisteria would faithfully perform the Contracts. As is customary in the surety industry, Wisteria contacted Bond Safeguard and requested that it furnish bonds on its behalf. *Id.* As a precondition to issuing bonds, Bond Safeguard required Chris Hatch, Stacie Hatch, and Wisteria Corporation (collectively “Wisteria”) sign an Indemnity Agreement, in which they promised to reimburse and protect Bond Safeguard from and against any losses or liability arising out of the Bonds. *Id.*

In late 2006 and early 2007, DNR declared Wisteria in default on both timber sale contracts. *CP 248*. Over the course of the next 12 months, both Bond Safeguard and Wisteria attempted to resolve DNR’s claims against Wisteria and the Bonds, with no success. *Id.* At that point, Wisteria had already breached its contractual duty to save Bond Safeguard harmless from all claims and liability and, ultimately, Bond Safeguard was

forced to satisfy DNR's claim in order to protect itself against further liability. *Id.* Truly, had Bond Safeguard not brought this matter to a speedy resolution, all parties would be mired down in a morass of costly litigation with DNR that would no doubt exceed the cost of DNR's original claim. *Id.*

B. The Indemnity Agreement

On December 9, 2005, Wisteria Chris Hatch and Stacie Hatch and Wisteria signed an Indemnity Agreement. *CP 249; CP 167 (Decl. Friedrich: Ex. A)*. Pursuant to the Indemnity Agreement, Wisteria contractually promised to both reimburse and protect Bond Safeguard from and against all losses and claims:

The Indemnitors will indemnify and save the Company harmless from and against every claim, demand, liability, cost, charge suit, judgment and expense which the Company may pay or incur in consequence of having executed, or procured the execution of, such bonds...

CP 249; CP 167 (Decl. Friedrich: Ex. A: General Indemnity Agreement ¶

2). The Indemnity Agreement also provides that Bond Safeguard is entitled to recover all attorney's fees and costs incurred "[i]n bringing suit to enforce the obligation of any of the Indemnitors under this Agreement." *Id.*

Most importantly, the Indemnity Agreement contains a "Right-to-Settle" provision. *CP 249; CP 167*. This clause grants Bond Safeguard

the exclusive right and absolute discretion to settle any claim made against the bonds:

The Company shall have the exclusive right to determine for itself and the Indemnitors whether any claim or suit brought against the Company or the Principal upon any bond shall be settled or defended and its decision shall be binding and conclusive upon the Indemnitors.

Id. at ¶ 5. And last, but certainly not least, Wisteria expressly waived its right to receive notice of Bond Safeguard's intent to settle any claims made against the Bonds. *Id. at ¶ 7.*

C. Wombat Timber Sale Contract

On March 14, 2005, DNR entered into the Wombat timber sale contract No. 30-07629 with Wisteria. *CP 249; CP 167 (Decl. Friedrich: Ex. B).* Bond Safeguard issued two bonds to guarantee Wisteria's compliance with the Wombat contract: (1) Performance Bond No. 5020306 and (2) Payment Bond No. 5021036. *CP 249; CP 167 (Decl. Friedrich: Ex. C, D).* The aggregate penal sum of the Bonds was \$22,000. *Id.*

On March 15, 2007, DNR directed correspondence to Wisteria and Bond Safeguard stating that Wisteria had defaulted under the Wombat contract. *CP 250; CP 167 (Decl. Friedrich: Ex. E).* Pursuant to this notice, DNR demanded immediate payment of \$19,693.12 as liquidated damages under the contract. *Id.* Among other things, the DNR noted that

Wisteria failed to complete all work by the date called for in the contract and failed to pay for 67.94 tons of timber. *Id.* On April 23, 2007, DNR renewed its previous demand on Wisteria and Bond Safeguard to pay damages based on Wisteria's failure to comply with the Wombat contract. *CP 250; CP 167 (Decl. Friedrich: Ex. F).* On May 3, 2007, DNR directed correspondence directly to the President of Bond Safeguard demanding payment of \$15,781.91, plus interest, within thirty days. *CP 250; CP 167 (Decl. Friedrich: Ex. G).*

Over the next several months, Wisteria, Bond Safeguard, and DNR engaged in protracted negotiations to try to resolve its claim. *CP 250; CP 167 (Decl. Friedrich: Ex. H, I).* Bond Safeguard actively monitored the claim, but took a more passive role in the investigation of the claim because Wisteria's President, Chris Hatch, did not want Bond Safeguard to incur any expenses handling the claims. *CP 250; CP 167 (Decl. Friedrich: Ex. H)* (emails from Elaine Marcus dated April 2, 2007, and April 23, 2007); *CP 167 (Decl. Friedrich: Ex. BB)* (email from Elaine Marcus dated February 22, 2007). In addition, Bond Safeguard relied mostly upon Wisteria to resolve DNR's claims because Wisteria had a contractual duty to "save the Company harmless from and against every claim." It was Wisteria that was duty bound to investigate and resolve the claim, not Bond Safeguard.

Nevertheless, Bond Safeguard remained active in trying to resolve DNR's claim by facilitating proactive communication between counsel for both Wisteria and DNR. *CP 250; CP 167 (Decl. Friedrich: Ex. H, I)*. This is reflected in a series of emails between Bond Safeguard's attorney, Bruce Maas, Bond Safeguard's claims examiner, Cindy Raftery, and surety bond broker, Elaine Marcus. *CP 251*. At all times, Bond Safeguard remained optimistic that both parties could successfully resolve DNR's claim without having to forfeit the Bonds. *Id.*

Toward that end, Bond Safeguard strongly encouraged Wisteria to initiate "positive" negotiations with DNR and, similarly, encouraged DNR to meet with Wisteria representatives. *CP 251; CP 167 (Decl. Friedrich: Ex. H, I)*. In fact, and despite much resistance from DNR, Bond Safeguard actually arranged a meeting between DNR and Wisteria with the hope that both sides could reach a compromise. *CP 251; CP 167 (Decl. Friedrich: Ex. J)* (email from Bruce Maas dated July 24, 2007). However, for reasons unknown to Bond Safeguard, DNR and Wisteria were unable to reach a settlement as to Wisteria's liability under the Wombat contract.

After DNR first notified Bond Safeguard of Wisteria's default under the Wombat contract, Bond Safeguard withheld payment from DNR for nearly 6 months in order to buy Wisteria some time to resolve the claims. *CP 251*. In fact, DNR was so infuriated with Bond Safeguard's

unwillingness to release the Bonds, it eventually filed two complaints with the Washington Insurance Commissioner's Office in September 2007. *CP 251; CP 167 (Decl. Friedrich: Ex. K)*. DNR also submitted these complaints to the Illinois Department of Financial and Professional Regulation. *Id.* Among other things, DNR requested that the Insurance Commissioner's Officer investigate, fine, and suspend or revoke Bond Safeguard's license to conduct business in Washington. *Id. (Decl. Friedrich: Ex. L)*. Ultimately, because Wisteria failed to resolve its dispute with DNR and, similarly, failed to comply with its contractual duty to hold Bond Safeguard harmless, Bond Safeguard exercised its "Right-to-Settle" provision, and paid the DNR \$17,007.64 on September 21, 2007. *CP 251-52; CP 167 (Decl. Friedrich: Ex. M, N, and O)*.

D. Turtle Pole Timber Sale Contract

On July 7, 2005, Wisteria entered into the Turtle Pole timber sale contract No. 30-055760. *CP 252; CP 167 (Decl. Friedrich: Ex. P)*. Bond Safeguard issued two bonds to guarantee Wisteria's compliance with the Turtle Pole contract: (1) Performance Bond No. 5020305 and (2) Payment Bond No. 5022033. *Id. (Decl. Friedrich: Ex. Q, R)*. The aggregate penal sum of the Bonds was \$27,000. *Id.*

On September 27, 2006, DNR first notified Bond Safeguard of Wisteria's default under the Turtle Pole contract. *CP 252; CP 167 (Decl.*

Friedrich: Ex. S). Among other things, DNR noted that Wisteria was in violation for “over-harvesting” timber and for failing to properly tag stumps after felling timber. *Id.* On December 22, 2006, DNR first notified Bond Safeguard of its demand against the Bonds. *Id. (Decl. Friedrich: Ex. T).* On May 23, 2007, DNR, again, set forth the details of Wisteria’s breach of the Turtle Pole contract, and requested that Bond Safeguard make immediate payment on the Bonds. *Id. (Decl. Friedrich: Ex. U).* On June 22, 2007, an agent of Bond Safeguard spoke with DNR by phone, requesting that Wisteria be given another opportunity to talk with DNR in an effort to resolve the claim. *Id. (Decl. Friedrich: Ex. V).* By letter dated June 29, 2007, DNR rejected Bond Safeguard’s request, and again demanded that Bond Safeguard immediately release the Bonds; otherwise, DNR threatened immediate legal action. *Id.*

In the meantime, Bond Safeguard continued to request that Wisteria be given an opportunity to meet with DNR to negotiate a resolution. *CP 252-253; CP 167 (Decl. Friedrich: Ex. J)* (email from Bruce Maas dated July 24, 2007), *CP 253; CP 167 (Decl. Friedrich: Ex. W)* (email from Bruce Maas dated July 24, 2007). Despite much resistance from DNR, Bond Safeguard eventually arranged a meeting between Wisteria and Bruce Mackey – a land steward with the DNR. *CP 253; CP 167 (Decl. Friedrich: Ex. X)* (email from Bruce Maas dated July

31, 2007); *CP 253; CP 167 (Decl. Friedrich: Ex. Y)* (email from Bruce Maas dated August 3, 2007). However, much like the Wombat contract, Wisteria was unable to successfully resolve the DNR's claim, despite Bond Safeguard's tireless efforts to facilitate a compromise. *CP 253.*

Much like the DNR's claim against the Wombat contract, Bond Safeguard withheld payment from the DNR for an entire year in order to buy Wisteria some time to resolve the Turtle Pole claim. *CP 254.* In fact, DNR was so upset with Bond Safeguard's unwillingness to release the Bonds, it eventually filed two complaints with the Washington Insurance Commissioner's Office in September 2007. *CP 254; CP 167 (Decl. Friedrich: Ex. K).* Among other things, DNR requested that the Insurance Commissioner's Officer investigate, fine, and suspend or revoke Bond Safeguard's license to conduct business in Washington. *CP 254; CP 167 (Decl. Friedrich: Ex. Z).* Ultimately, because Wisteria failed to resolve its dispute with the DNR and, similarly, failed to comply with its contractual duty to hold Bond Safeguard harmless, Bond Safeguard exercised its "Right-to-Settle" provision, and settled DNR's claim for \$27,000 on September 21, 2007. *CP 254; CP 167 (Decl. Friedrich: Ex. AA).*

III. LEGAL ARGUMENT

A. Standard of Review

When reviewing a trial court's summary judgment ruling, the appellate court engages in the same inquiry as the trial court. *Halleran v. Nu W., Inc.*, 123 Wash.App. 701, 709, 98 P.3d 52 (2004). The appellate court must affirm a ruling granting summary judgment if no genuine issue of material fact remains and the moving party is entitled to judgment as a matter of law. CR 56(c).

This Court reviews a trial court's denial of a motion for reconsideration for abuse of discretion. *Davies v. Holy Family Hosp.*, 144 Wn.App. 483, 497, 183 P.3d 283 (2008). A trial court abuses its discretion only if its decision is manifestly unreasonable or rests upon untenable grounds or reasons. *Id.* An abuse of discretion exists only if no reasonable person would have taken the view adopted by the trial court. *Id.* Accordingly, if a trial court's ruling is based upon tenable grounds and is within the bounds of reasonableness, it must be upheld. *Showalter v. Wild Oats*, 124 Wash.App. 506, 101 P.3d 867 (2004).

B. The Trial Court properly granted Bond Safeguard's Motion for Summary Judgment and denied Wisteria's Motion for Reconsideration.

As a general rule, "[t]he one exception to enforcement of a principal's liability under an Indemnity Agreement is the surety's bad faith

or fraudulent payment.” *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d 579, 585 (M.D. Pa. 1998), aff’d 185 F.3d 864 (3rd Cir. 1999) (emphasis added). Thus, a claim of fraud or bad faith acts as a defense and, if properly supported, creates a genuine issue of material fact. *Id.* This is known as the good faith standard and is only one of two recognized defenses that the indemnitors may raise in opposition to a surety indemnity claim – the other being the reasonableness standard. In this matter, Wisteria has not, and cannot, produce any evidence that would show bad faith, and for that reason – alone – the trial court properly granted Bond Safeguard’s Motion for Summary Judgment.

Because Wisteria has no evidence to show bad faith, Wisteria urges this Court to apply the reasonableness standard. But even if the Court were to apply the reasonableness standard, summary judgment is still proper because the express terms of the Indemnity Agreement, the law supporting a surety’s broad indemnity rights, and the facts show that Bond Safeguard acted reasonably under the circumstances.

Where there is an express indemnity agreement, the rights of the parties are governed by the terms of the contract. *Commercial Ins. Co. of Newark, N.J. v. Pacific-Peru Constr. Corp.*, 558 F.2d 948, 953 (9th Cir. 1977). Wisteria’s unsupported allegation that Bond Safeguard acted unreasonably must be viewed in light of the broad rights afforded Bond Safeguard under the Indemnity Agreement. Wisteria cannot possibly argue that Bond Safeguard acted unreasonably when Bond Safeguard acted squarely within the broad rights afforded it under the Indemnity

Agreement. Truly, Bond Safeguard is at a loss as to how it could have acted unreasonably and outside the reasonable expectation of the parties when it had the express contractual authority to settle claims, and that such authority was binding and conclusive on Wisteria. With these contractual rights in mind, it is inconceivable that Bond Safeguard acted unreasonably.

Wisteria's argument that Bond Safeguard's acted unreasonably is threefold: (1) that Bond Safeguard unreasonably settled DNR's claim in order to protect itself; (2) that Bond Safeguard failed to reasonably consider Wisteria's defenses to DNR's claim; and (3) that Bond Safeguard unreasonably settled with DNR's over Wisteria's objection.

First, Wisteria cannot show unreasonableness when, as a matter of law, Bond Safeguard has a "right to indemnification for claims paid to protect its own interests." *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d at 586. Second, Wisteria cannot demonstrate unreasonableness when, as a matter of law, a surety has a right to indemnification regardless of whether or not liability actually existed. *Commercial Ins. Co. v. Pac./Peru Constr.* 558 F.2d 948, 953 (9th Cir. 1977). Third, Wisteria cannot seriously argue that Bond Safeguard acted unreasonably when Bond Safeguard's decision to settle a claim "shall be binding and conclusive upon the Indemnitors." *CP 167 (Decl. Fried. Ex. A: Agreement ¶ 5)*.

1. Bond Safeguard has a contractual right to settle claims to protect itself.

It is generally held that a surety has wide discretion to settle claims in order to protect itself and lessen its liability if the Indemnity Agreement requires the principal to “save” or “hold” the surety harmless. *Fid. and Deposit Co. of Md. v. Bristol Steel & Iron Works, Inc.*, 722 F.2d 1160, 1165 (4th Cir. 1983). The Indemnity Agreement requires Wisteria to “save [Bond Safeguard] harmless from and against every claim.” *CP 167 (Decl. Fried. Ex. A: Agreement ¶ 2)*. It is undisputed that Wisteria’s inability to settle DNR’s claim exposed Bond Safeguard to significant attorney’s fees and costs, and the real threat of regulatory sanctions. Wisteria cannot now complain that Bond Safeguard chose to settle with DNR when Wisteria contractually agreed that Bond Safeguard would have the “exclusive right to determine for itself and the Indemnitors” whether any claim should be settled. *Id. at ¶ 5*.

Most erroneous of all is Wisteria’s assertion that “Bond Safeguard had a contractual duty to defend Wisteria against DNR’s claim.” *CP 151*. This statement could not be further from the truth. Even under the most perverse interpretation of the Indemnity Agreement, no reasonable person could find that Bond Safeguard owed any duty to protect Wisteria. Rather, it was Wisteria and the individual indemnitors that had a duty to indemnify and save Bond Safeguard harmless. The Indemnity Agreement was entered into for the benefit of Bond Safeguard, not Wisteria. Wisteria

cannot seriously argue that the parties executed the Indemnity Agreement with the intent that it would protect Wisteria.

2. Bond Safeguard has a contractual right to settle claims and seek indemnity despite the fact that Wisteria may have had defenses to DNR's claim.

The Indemnity Agreement provides that Bond Safeguard is entitled to reimbursement for all losses and expenses which it may incur “in consequence of having executed...bonds.” *CP 167 (Decl. Fried. Ex. A: Indemnity Agreement ¶ 2)*. Courts have interpreted such provisions to provide for indemnity even where the principal was not actually liable. *Commercial Ins. Co. v. Pac./Peru Constr.* 558 F.2d at 953. “The broad terms of the clause provide indemnification for any loss suffered by El Pacifico by ‘reason . . . of having executed’ the performance bond.” *Id.* Courts have uniformly held that it is irrelevant whether the principal was actually liable or actually defaulted on its contract so long as there was no fraud or collusion between the surety and the claimant. *General Acc. Ins. Co. of America v. Merritt-Meridian Const. Corp.*, 975 F.Supp. 511, 516 (S.D.N.Y. 1997). Accordingly, Wisteria’s argument that Bond Safeguard was required to find that DNR’s claim was valid before making payment is inconsistent with the Indemnity Agreement and the law.

3. Bond Safeguard has a contractual right to settle claims over Wisteria’s objection.

Wisteria argues that Bond Safeguard should have withheld settlement and litigated the claim with DNR. True to form, Wisteria

asserts contract rights that have no basis in fact or law. The Indemnity Agreement granted Bond Safeguard the “exclusive right” to settle any claim. Courts have interpreted such provisions to allow the surety to effectively and efficiently resolve claims, seek immediate reimbursement from the indemnitors, and avoid unnecessary and costly litigation. *Transamerica Ins. Co. v. Bloomfield*, 401 F.2d 357, 362-63 (6th Cir. 1968). Furthermore, courts have recognized that the “purpose of a surety [is] to protect the obligee,” not the principal, and that the surety has a right to protect itself. *Liberty Mut. Ins. Co. v. Aventura Eng'g & Const. Corp.*, 534 F. Supp. 2d 1290, 1305 (S.D. Fla. 2008). Wisteria cannot point to any language in the Indemnity Agreement or any applicable law that would preclude Bond Safeguard from settling claims over Wisteria’s objection.

4. Because Bond Safeguard settled DNR’s claims in good faith, the Trial Court properly granted Bond Safeguard’s Motion for Summary Judgment.

Courts have uniformly held that the only exception to a surety’s right to indemnity is bad faith or fraudulent payment. *Bristol Steel & Iron Works, Inc.*, *supra*, 722 F.2d at 1163. The *Bristol Steel* Court stated without qualification that “any challenge to such payment must be rested solely on that claim of bad faith or fraud.” *Id. citing Engbrock v. Federal Ins. Co.*, *supra*, 370 F.2d at 786.

In addition, several courts have addressed the precise question raised on appeal – that is, whether an indemnitor must show bad faith in order to defeat a surety’s motion for summary judgment. Indeed, a

majority of courts have concluded that the indemnitor must show bad faith or fraud in order to defeat summary judgment. *Fireman's Ins. Co. of Newark, N.J. v. Todesca Equipment Co., Inc.*, 310 F.3d 32, 37-39 (1st Cir. 2002). Because Wisteria cannot show bad faith, the trial court properly granted summary judgment in favor of Bond Safeguard.

C. The Court should adopt the majority rule governing a surety's right to indemnity and reject the minority rule advocated by Wisteria.

The weight of authority seems to be on the side of recognizing a duty of good faith. *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 267 Conn. 279, 304 (2004). The majority of courts agree that the principal must establish something more than mere negligence to prove bad faith or the absence of good faith. *Id.*; See, e.g., *Engbrock v. Federal Ins. Co.*, 370 F.2d 784, 787 (5th Cir.1967) (“neither lack of diligence nor negligence is the equivalent of bad faith”); *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d 579, 587 (M.D. Pa. 1998) (“[g]ross negligence or bad judgment is insufficient to amount to bad faith”); *Employers Ins. of Wausau v. Able Green, Inc.*, 749 F.Supp. 1100, 1103 (S.D.Fla. 1990) (surety's actions may have been negligent but did not rise to level of deliberate malfeasance required to establish bad faith).

In those jurisdictions that do further define the good faith or bad faith standard, one common characterization used frequently, is that bad faith, means that the surety acted with an “improper motive” or “dishonest

purpose.” *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 267 Conn. 279, 304 (2004). This standard preserves a proper balance between affording the surety the wide discretion to settle that it requires, while ensuring that the principal is protectect against serious and wilfull transgression. *Id.* at 305. With this standard in mind, Bond Safeguard’s alleged unreasonable investigation, standing alone and not accompanied by other evidence of an improper motive, is not enough to defeat its claim for indemnity. *Id.* at 310. As discussed above, this is the majority rule and is based on sound public policy reasons, as discussed in greater detail below.

On appeal, Wisteria’s requests that the Court adopt the minority view, which is the reasonableness standard, but in doing so, Wisteria fails to provide any practical reasoning for the Court to adopt this minority rule. A closer look at the unique tripartite relationship between the surety, the principal, and the obligee, along with the economic realities of the construction industry, explain why a majority of courts uphold a surety’s right to reimbursement subject only to the exception of bad faith or absence of good faith.

This unique relationship is highlighted in John Hinchey’s essay on surety law, which explains how sureties face a nearly impossible dilemma

(much like in this case) when stuck between the conflicting demands of the obligee and the principal:

The obligee demands performance, and the surety fails or refuses to perform upon the pain of consequential damages, statutory penalties, interest, and attorney's fees. On the other hand, the principal protests that because the principal is not liable to the obligee, neither is the surety liable; and further, if the surety does perform over protest of the principal, the principal will raise defenses to the surety's claim for indemnity.

CP 59; Hinchey, John W., Surety's Performance Over Protests of Principal: Considerations and Risks, 22 Tort & Ins. L.J. 133, 134 (Fall 1986). Therefore, in order for a surety to be able to effectively and efficiently resolve claims, sureties need to know that they will be able to seek reimbursement without having to resort to costly litigation in order to recover their losses. As such, sureties are given wide discretion to settle claims because of the important function they serve in the construction industry, and because the economic incentives motivating them are a sufficient safeguard against payment of invalid claims, e.g., engaging in costly and protracted litigation to enforce the Indemnity Agreement. *General Acc. Ins. Co. of America v. Merritt-Meridian Const. Corp.*, 975 F.Supp. 511, 516-17 (1997).

Second, because sureties are so vital to the construction industry, the financial solvency of municipalities, and the protection of the general

public, it is necessary that sureties be able to settle claims efficiently and effectively, and seek immediate reimbursement. The “bad faith” standard is critical, and without it, “guaranty companies could not safely do business anything like as cheaply as they do, and to the evident advantage of the parties and the general public.” *Merritt-Meridian Const. Corp.*, 975 F.Supp. at 516-17 (quoting *Nat’l Surety Co. v. Fulton*, 183 N.Y.S. 237, 192 A.D. 645 (1920)). In addition, a majority of courts have recognized that the purpose of the “bad faith” standard is to facilitate the handling of settlements by sureties and protect them from unnecessary and costly litigation. *Transamerica Ins. Co. v. Bloomfield*, 401 F.2d 357, 362 (6th Cir. 1968).

1. Wisteria’s argument that the Court should adopt the reasonableness standard relies on the illogical notion that Washington’s insurance regulations are intended to protect the principal under a surety bond.

Incredibly, Wisteria argues that Washington’s insurance regulations impose a duty upon Bond Safeguard to conduct a reasonable investigation for the benefit of Wisteria. Wisteria’s erroneous interpretation of Washington’s insurance regulations ignores both the statutory authority for such regulations and the clear purpose behind the statutory authority. RCW 48.30.010 and RCW 48.30.015, otherwise known as the Insurance Fair Conduct Act (“IFCA”), grant the Insurance

Commissioner the power to promulgate rules and regulations governing the insurance claims handling practices. RCW 48.30.010 specifically states as follows:

An insurer engaged in the business of insurance may not unreasonably deny a claim for coverage or payment of benefits to any first party claimant.

(emphasis added). RCW 48.30.015(4) defines first party claimant as “an individual, corporation...or other legal entity asserting a right to payment as a covered person under an insurance policy or insurance contract...” Subsection (5) provides that any violation of WAC 284-30 constitutes an unreasonable denial of coverage to a first party claimant. Significantly, all of the unfair claim settlement practices listed in WAC 284-30 are specifically designed to protect a first-party claimant – that is, the insured. Nowhere in the IFCA does the legislature use any term other than first party claimant to designate the class of persons intended to be protected from the unfair practices cited in WAC 284-30 or RCW 48.30.

Applied to a surety bond, the definition of first party claimant can only conceivably encompass the obligee under the bond – namely, DNR, because DNR is the only legal entity that can assert a right to payment under the surety bonds. Because Wisteria has no right to payment as a covered person under a surety bond, it is not within the class of persons intended to be protected by WAC 284-30 or RCW 48.30 and, therefore,

Wisteria's argument that Bond Safeguard owed it a duty to conduct a reasonable investigation is misplaced. Because DNR is the only party that is the functional equivalent of a first party claimant, Wisteria and the Hatches have no right to claim that Bond Safeguard owed them a duty to conduct a reasonable investigation.

In fact, Washington courts have addressed the precise issue raised in this case – that is, can someone other than a first party claimant bring a assert violations against an insurer under RCW 48.30. In *Tank v. State Farm Fire & Cas. Co.*, the Washington Supreme Court held that the State's unfair claim settlement practices regulations, set forth in WAC 284-30-300 through 600, provide no cause of action for persons other than first party claimants against insurers. 105 Wn.2d 381, 392-94, 715 P.2d 1133 (1986).

The Court noted that nothing in the language of the regulations gives persons other than first party claimants the right to enforce the rules or indicates an intent by the insurance commissioner to create such a right. *Id. at* 393. Because persons other first party claimants are not intended beneficiaries of insurance policies, they have no right of action against insurers. *Dussault ex rel. Walker-Van Buren v. American Intern. Group, Inc.*, 123 Wn.App. 863, 867, 99 P.3d 1256 (2004). Here, much like the

third-party claimants in *Tank* and *Dussault*, Wisteria and the Hatches are neither first party claimants nor intended beneficiaries of the surety bonds.

Because Wisteria is not a first party claimant, Wisteria cannot possibly claim that Washington's insurance regulations impose a duty upon Bond Safeguard to reasonably investigate claims for its benefit or protection, or that an alleged failure to reasonably investigate should effectively foreclose Bond Safeguard's right to indemnity.

D. Even if this Court adopts the reasonableness standard, as opposed to the good faith standard, summary judgment was still proper.

Wisteria advances a standard adopted by a clear minority of jurisdictions. Rather than apply the "good faith" standard, which is the majority rule, Wisteria urges this Court to adopt a reasonableness standard. Not only should this Court adopt the majority rule as set forth above, but even if this Court were to apply the minority rule, there is no evidence to suggest that Bond Safeguard acted unreasonably. The rule that Wisteria urges this Court to adopt on appeal is as follows:

Parties to an indemnity agreement which subjects the right to compromise a claim against the principal to the sole discretion of the surety must reasonably expect that compromise and payment will be made only after reasonable investigation of the claims, counterclaims and defenses asserted in the underlying action.

City of Portland v. Ward & Associates, Inc., 89 Or.App. 452, 457-58, 750 P.2d 171 (1988). Most important, however, is the Oregon Court's

holding that a surety, in compromising a claim, must exercise its discretion “so that the reasonable expectation of the parties [will] be effectuated. *Id.* at 457. Here, there is no question that Bond Safeguard settled claims within the reasonable expectation of the parties. By signing the Indemnity Agreement, Wisteria granted Bond Safeguard the sole and absolute discretion to settle or defend claims. Moreover, Wisteria agreed that Bond Safeguard’s decision to settle claims would be conclusive and binding. Now, Wisteria seek to repudiate the foregoing provisions, and argue that Bond Safeguard’s decision to settle is not binding, and that Bond Safeguard should have given more consideration to Wisteria’s interests. Wisteria is, in essence, advancing an interpretation of the Indemnity Agreement that would effectively require Bond Safeguard to indemnify and hold harmless Wisteria. This is an absurd result, and the opposite of what an Indemnity Agreement is intended do – that is, protect the surety and the obligee.

But even if the Court were to adopt the standard set forth in *City of Portland*, Bond Safeguard could not possibly have acted unreasonably in settling DNR’s claims because Wisteria cannot identify any counterclaims or defenses that Bond Safeguard failed to consider. Throughout the claims handling process, Wisteria failed to provide any reliable information with regard to DNR’s claims and only made generalized statements in

opposition to DNR's claim. To date, Wisteria has failed to raise any claims or counterclaims against DNR for wrongful termination under the Turtle Pole and Wombat contracts. Wisteria makes the bare assertion that Bond Safeguard conducted an unreasonable investigation, but fails to produce one affidavit, declaration, email, letter, or documentary exhibit to corroborate this conclusory allegation. Simply put, Wisteria has failed to produce any evidence to show that Bond Safeguard's investigation was unreasonable.

E. There is no evidence that Bond Safeguard's investigation was not in good faith or unreasonable.

Wisteria's entire appeal relies on the naked assertion that Bond Safeguard settled DNR's claim without first conducting a reasonable investigation. Remarkably, this assertion assumes that Bond Safeguard had no internal investigative procedures, made no effort to evaluate the merits of DNR's claims, and that Bond Safeguard failed to consider any of the information submitted to it by DNR and Wisteria.

In reality, Bond Safeguard made its decision to settle after an exhaustive evaluation of the contract documents, extension agreements, correspondence and telephone conversations with DNR officials and its attorneys, correspondence and telephone conversations with Wisteria and its attorneys, and internal discussions between Bond Safeguard's claims

analysts and its attorneys who closely monitored the negotiations between DNR and Wisteria. *CP 167 -246 (Decl. Friedrich Exs. A – CCC); CP 20-33 (2nd Decl. Friedrich Exs. A – EEE)*. To say that Bond Safeguard’s investigation was unreasonable ignores the evidence.

Throughout the course of its investigation, Bond Safeguard considered the expert and legal opinions of numerous qualified officials at DNR – namely, Theresa Klepl (Management Forester), Rich Sluss (Proprietary Forester), William J. Wallace (Northwest Region Manager), Erin E. Fonville (Contract Administrator), William O. Boyum (Southeast Region Manager), R. Bruce Mackey (Lands Steward), and MD Newberry (Assistant Attorney General for DNR). *CP 167-246 (Decl. Friedrich Exs. F, S, T, and V); CP 20-33 (2nd Decl. Friedrich Exs. A, B, and C)*. Bond Safeguard also considered the opinions of Wisteria’s President, Chris Hatch, and Wisteria’s attorneys, but their defenses paled in comparison to the overwhelming evidence produced by DNR. The diversity and credibility of opinion provided to and considered by Bond Safeguard and its attorneys demonstrates conclusively that Bond Safeguard’s decision to settle was in good faith, reasonable, and based on credible evidence.

F. Wisteria's reasonableness argument is meaningless because Wisteria fails to show that a reasonable investigation would've revealed facts showing that DNR's decision to terminate was wrongful.

Wisteria makes the abstract argument that Bond Safeguard was required to make a reasonable investigation, but fails to mention, with any specificity whatsoever, what facts a reasonable investigation would've revealed in opposition to DNR's claim. Other than make generalized assertions and self-serving statements, Wisteria has yet to produce one piece of evidence or provide one fact-based explanation as to how DNR wrongfully terminated the timber contracts. Wisteria cannot cite one letter, email, conversation, or documentary exhibit that was provided to Bond Safeguard during the investigative process that would have alerted Bond Safeguard to the fact that Wisteria was wrongfully terminated. Surely, the Indemnity Agreement does not impose upon Bond Safeguard the duty to unearth facts that do not exist or are not disclosed by parties during the course of the investigation.

If Wisteria feels that it was wrongfully terminated, it had every right to sue DNR for breach of contract. Five years have passed since DNR terminated Wisteria under the contract and Wisteria has still yet to bring a claim. Undoubtedly, Defendants' failure to bring a civil claim against DNR speaks volumes about the validity of DNR's termination of the contract, and confirms the propriety of Bond Safeguard's decision to settle DNR's claim.

Had Wisteria truly believed that it had legitimate defenses to DNR's termination of the Contracts, it could have (and still can) brought a civil claim against DNR. To this date, Wisteria has declined DNR's invitation to have this matter decided on the merits, perhaps because there are no true defenses to DNR's claim. Moreover, Bond Safeguard provided Wisteria nine months to sue DNR, but seeing no intention, nor urgency, on the part of Wisteria to resolve this matter, Bond Safeguard had an regulatory obligation to pay DNR under WAC 284-30-330.

Not only did Bond Safeguard have the sole and absolute discretion to settle this claim as authorized by the Indemnity Agreement, but Bond Safeguard could not risk waiting around endlessly for Wisteria to resolve DNR's claim; Bond Safeguard was bound by WAC 284-30-370 to settle claims within thirty days after notification of the claim. More than that, though, Bond Safeguard had the right to settle claims without notice to Wisteria. *CP 167 (Decl. Friedrich Ex. A. Indemnity Agreement ¶ 7)*. In fact, Bond Safeguard put itself at risk by allowing Wisteria to negotiate with DNR for nine months before it finally settled DNR's claim. There is no language in the Indemnity Agreement or in Washington's insurance regulations that allows, let alone requires, a surety company to hold-off settling a claim for nine months in order to give the principal time to resolve the dispute. Moreover, there is no right found anywhere is the

Indemnity Agreement, which required Bond Safeguard to withhold settlement in order to allow Wisteria to negotiate or litigate with the obligee. In fact, the Indemnity Agreement provides just the opposite – that is, Bond Safeguard can settle immediately, without notice to Wisteria.

G. Motion to Strike.

Bond Safeguard moves to strike Wisteria's Opening Brief because Wisteria has twice failed to timely file its Opening Brief. Wisteria's Opening Brief was originally due to be filed on March 2, 2012. On March 1, 2012, Wisteria's hired new counsel and requested a 30 day extension to file its Opening Brief. On March 7, 2012, the Court granted Wisteria an extension to file and serve its brief no later than April 6, 2012. Bond Safeguard did not receive Wisteria's Opening Brief until April 9, 2012. Wisteria's flagrant disregard of the rules of appellate procedure, especially after the Court's willingness to grant an extension, is inexcusable and Wisteria's appeal should be dismissed.

H. Bond Safeguard is entitled to an award attorney's fees and costs on appeal.

Under RAP 14.2, this Court may award costs to the prevailing party on appeal. Bond Safeguard respectfully requests an award of its costs incurred on this Appeal. Furthermore, pursuant to RAP 18.1, this Court may award reasonable attorney's fees or expenses on review. Bond

judgment and order denying Wisteria's motion for reconsideration.

RESPECTFULLY SUBMITTED this 9th day of May
2012.

YUSEN & FRIEDRICH

By 

Alexander Friedrich, WSBA # 6144
Paul Friedrich WSBA #43080
Attorneys for Respondent
Bond Safeguard Insurance Company

DECLARATION OF SERVICE

Vanessa Stoneburner declares:

On May 9th, 2012, I emailed as well as mailed a copy of the foregoing document by United States first-class mail, with proper postage affixed, to:

Scott Stafne
Andrew J. Krawczyk
Attorney at Law
239 N. Olympic Avenue
Arlington, WA 98223

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

EXECUTED THIS 9th day of May, 2012, at
Seattle, Washington.



Vanessa Stoneburner