

Consolidated Case No. 68117-6-I

COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

STEADFAST INSURANCE COMPANY,

Intervenor Appellant

v.

THE ESPLANADE CONDOMINIUM ASSOCIATION, AFE
SPINNAKER, LLC, AF EVANS COMPANY, AF EVANS
DEVELOPMENT INC., RICHARD BELL, JACK ROBERTSON, TORY
LAUGHLIN TAYLOR, TRAVELERS PROPERTY CASUALTY
COMPANY OF AMERICA AND HEFFERNAN INSURANCE
BROKERS,

Respondents

**BRIEF OF INTERVENOR APPELLANT STEADFAST
INSURANCE COMPANY**

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FILED
APR 30 10 41 AM '07
COURT OF APPEALS
DIVISION I
SEATTLE, WA
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I. INTRODUCTION

The purpose of requiring a defendant to pay interest on a judgment is to compensate the plaintiff for the lost value of money when it was properly attributable to the plaintiff. The legislature has clearly expressed its intent for courts to impose different interest rates depending upon what the judgment is based. Judgments founded on tortious conduct bear a different interest rate than those founded on a contract. Where a judgment is based on multiple claims, it is the task of the court to determine the central thrust of the claims, as only one interest rate can apply.

In this matter, the trial court erred when it applied an interest rate of 12%. Instead, the court should have determined the primary nature of the claims and damages upon which the settlement and stipulated judgments were based. A review of the underlying litigation reveals that the claims driving the settlement negotiations stem from the same basic factual contentions: The negligent and/or fraudulent failure to identify construction defects in the original sale materials for the property. As such, it is clear that the ultimate judgment in this matter has its basis in “tortious conduct.” Accordingly, this court should reverse the trial court’s erroneous entry of a contract-based interest rate and reflect the true basis of the settlement agreement by applying the tort-based rate.

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II. ASSIGNMENTS OF ERROR

(1) The trial court erred when it entered the stipulated judgment that had an interest rate of 12%. CP 3729-3732.

(2) The trial court erred when it denied the motion for reconsideration on the 12% interest rate. CP 3754-3755.

III. ISSUE PERTAINING TO ASSIGNMENTS OF ERROR

Did the trial court err in setting an interest rate of 12% based on Subsection (1) of RCW 4.56.110 because Subsection (3) instead controls?

IV. STATEMENT OF THE CASE

A. The Parties

This appeal results from the intervention by two insurance companies in a lawsuit brought against their insureds: Steadfast Insurance Company (“Steadfast”) and Travelers Property Casualty Company of America (“Travelers”). For its part, Steadfast insured AF Evans Company, Inc. (“AFECO”) and AF Evans Development, Inc. (“AFED”). As discussed more fully below, the Esplanade Condominium Association (“Association”) sued AFECO and AFED (and other defendants) for alleged damages associated with a condominium conversion. The AFECO and AFED parties ultimately settled and agreed to the entry of a stipulated judgment and the assignment of their insurance rights to the Association.

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B. Background

AFECO is a company that owned and operated multi-family residential buildings. Clerk's Papers (CP) at 1254. Its business included the purchase and conversion of apartment buildings into condominiums. CP at 1839. AFED was a wholly-owned subsidiary and the development arm of the family of Evans Companies. CP at 1254. In the case of apartment to condominium conversions, AFECO would establish a single purpose LLC to manage all aspects of the conversion. CP at 1122.

This lawsuit arises out the acquisition, renovation, and conversion of an apartment complex into a 168-unit condominium complex in Kirkland, Washington, known as The Esplanade, a Condominium. CP at 858; 2616. Originally constructed in the 1980s, it was purchased in 2005 by AFE Spinnaker, LLC ("Spinnaker"), the entity established by AFECO for the purpose of the Esplanade conversion project. CP at 1255. Spinnaker was the Project's declarant.¹ CP at 314. The conversion involved cosmetic upgrades to the interiors, such as paint, carpets, etc. CP

¹ Declarant means: (a) [a]ny person who executes as declarant a declaration ... or (b) [a]ny person who reserves any special declarant right in the declaration; or (c) [a]ny person who exercises special declarant rights or to whom special declarant rights are transferred; or (d) [a]ny person who is the owner of a fee interest in the real property which is subjected to the declaration at the time of the recording of an instrument pursuant to RCW 64.34.316 and who directly or through one or more affiliates is materially involved in the construction, marketing, or sale of units in the condominium created by the recording of the instrument." RCW 64.34.020(14). "'Declaration' means the document, however denominated, that creates a condominium ..." RCW 64.34.020(16).

at 2617. Spinnaker made no improvements to the buildings' exteriors. CP at 1264.

As part of the conversion process, Spinnaker retained the services of two companies, Marx/Okubo Associated, Inc. ("Marx/Okubo") and RDH Building Sciences, Inc. ("RDH"), to produce a reserve study and a building condition report. CP at 858. Marx/Okubo produced a Property Condition Assessment ("PCA") and a subsequent reserve study that together identified certain conditions of the property and set forth options for future reserves and monthly dues requirements to deal with those reserves. CP at 324-396 (PCA); CP at 398-415 (Reserve Study). The RDH investigation was performed under the Washington Condominium Act, Chapter 64.34 RCW ("WCA"), which requires additional disclosures regarding building envelope concerns. *See also* RCW 64.55.090(e). This report identified additional defects pertaining to the siding and roofing. *See* CP 69-162 (RDH Report). These reports were attached to the Public Offering Statement ("POS") when the condominiums were made available to the public for purchase. CP at 274; 322.

C. The Lawsuit and Settlement

On or about December 5, 2008, the Association filed a lawsuit against all three Evans entities, as well their individual officers and directors, Victoria Laughton-Taylor, Richard Bell, and John Robertson.

CP at 4-28. The Association alleged construction defects at the property involving exterior building components, such as the siding, windows, and roofing. CP at 10. At heart, the Association asserted that AFECO and AFED had committed misrepresentations and outright fraud in the marketing and sale of the condominium units. For example, the complaint alleged that AFECO and AFED as declarant alter egos issued a statutorily required inspection report that was:

... deceptive and misleading in that it: (a) does not disclose material defective conditions that were reasonably ascertainable by an independent, licensed architect or engineer undertaking a reasonable, good-faith examination of the Project's common elements, and/or (b) materially misrepresents the condition of the Project's structural and/or mechanical and/or electrical systems, and/or (c) does not report on the condition of all structural, mechanical and electrical systems material to the use and enjoyment of the Project.

CP at 16. The complaint alleged that AFECO and AFED as declarant alter egos caused the reserve study to be misleading:

Declarant Alter Egos ... deliberately refrained from informing Marx Okubo, which they had hired to prepare a "Reserve Study" for the public offering statement, of the presence of known, widespread, serious construction defects and damage at the Project. As a result, the "Reserve Study" ultimately produced by Marx Okubo and included in the public offerings statement, and its reserve contribution estimates, were grossly inaccurate.

CP at 15. The Association claimed that the initial unit purchasers relied upon the reports attached to the POS to their detriment and that they

suffered damages—such as cost of repairs and correcting the defective condition—as a proximate result of the defendants’ misrepresentations and fraud. CP at 17-19. Thus, as these allegations make clear, the Association’s liability claims were premised on AFECO’s and AFED’s purportedly tortious conduct.

At the time of the filing of the lawsuit, Spinnaker was the only entity that had been served. CP at 972. On June 23, 2009, the trial court entered a default order against Spinnaker after it had failed to appear. CP at 2690-91. Thereafter, the Association served the complaint on the remaining defendants, including AFED and AFECO. CP at 972. The Association’s theory was that the remaining defendants, as the “alter egos” of Spinnaker, were also liable as declarants and that Spinnaker’s misrepresentations and fraud applied equally to all defendants. *See* CP at 6-7.

On March 17, 2010, the Association moved for a default judgment against Spinnaker. CP at 543-561. Although Spinnaker was granted leave to defend against the motion, the superior court ultimately entered a default judgment against Spinnaker for \$8.081 million. CP at 764-767. Because the default judgment was essentially unenforceable—as Spinnaker had no assets—the Association continued to focus on AFECO

and AFED. *See* CP at 1255. In the meantime, AFECO had filed for bankruptcy protection in the Northern District of California. CP at 209-11.

With this background, settlement negotiations began in earnest. *See* CP at 1162. The suit culminated in a CR2A Settlement Agreement (“Settlement”) that was executed on July 22, 2010. CP at 1410-1439. Its terms included (1) entry of stipulated judgment against Spinnaker for \$8 million, (2) entry of stipulated judgment against AFECO and AFED for \$7.2 million, (3) a covenant not to execute the judgments against Spinnaker and AFED, (4) an outright release of the individual defendants, and (5) an assignment of the defendants’ insurance rights to the Association. *Id.*

With respect to the stipulated judgments, the Settlement contained the following clause:

Strictly subject to and conditioned upon the covenants set forth in paragraphs 2.4 – 2.4.4 below, and upon determination of attorney fees, costs, and [Consumer Protection Act] penalties as described above, the A.F. Evans Defendants shall sign and deliver to the Association the Stipulated Judgments against each of them, substantially in the forms attached hereto as Appendices A, B, and C, in favor of the Association²

² The conditions set forth in paragraphs 2.4 – 2.4.4 pertained to the covenants not to execute and the release of the individual defendants and all others.

CP at 1414. Appendices A, B, and C (“Appendices”) were attached to the Settlement and provided the basic form of the stipulated judgments to be entered by the defendants. CP at 1422-1439. The Appendices provided for a 12% interest rate. CP at 1423, 1428. The Appendices were, however, incomplete as the total judgment was unknown: the final amount was subject to a reasonableness determination by the court and Consumer Protection Act (“CPA”) penalties and attorney fees had not yet been determined. *Id.*; *see also* CP at 1030.

D. The Reasonableness Hearing

By way of background, Washington law permits insureds, when defendants, to negotiate and settle a claim in certain circumstances. *See generally Chaussee v. Maryland Ca. Co.*, 60 Wn. App. 504, 803 P.3d 1339 (1991). In this situation, the insured-defendants’ insurer may be held liable for the amount of a settlement that is reasonable and paid in good faith. *See Jackson v. Fenix Underground, Inc.*, 142 Wn. App. 141, 143-144, 173 P.3d 977 (2007) (citing *Chaussee*). This procedure is typically referred to as a “reasonableness hearing.” The hearing is made under the auspices of RCW 4.22.060, which Washington courts have taken from its original context, settlement among joint tortfeasors, and applied where a defendant settles with a plaintiff and assigns its insurance rights to that

plaintiff. *See generally Werlinger v. Warner*, 126 Wn. App. 342, 346, 109 P.3d 22, *review denied*, 155 Wn.2d 1025 (2005).

On December 10, 2010, the trial court held a reasonableness hearing. Just prior to this hearing, Steadfast and Travelers intervened. CP at 971-982; 1106-1116; 3388-90. The insurers contested the reasonableness of the settlement amount. CP at 1121-1152. The court agreed with the insurers and held that the stipulated judgments were unreasonable:

[T]he settlement reached in this matter and identified in the CR 2A Agreement dated July 22, 2010 is UNREASONABLE as a matter of law.

CP 3393. The trial court reasoned:

As for the issue left before me, that is the reasonableness of the settlement reached, I find that the amount of settlement was affected by the fact that the settling party did not have any direct interest in the amount. In other words, it was not directly affected by the amount that would have to be paid, and that did affect the nature of the negotiations in the amount. I find it an unreasonable amount.

12/10/2010 RP at 37:12-19. The court reduced the settlement amount from \$7.2 million to \$4,461,592.00. To this figure, the court added \$145,000 in previously awarded CPA penalties and \$514,417.75 in attorney fees, for a total of \$5,121,009.75. CP at 986-89; 3391-94. As a result, the trial court never entered the Appendices as the judgment.

Almost a year later, in October 2011, the Association presented the judgment to the court. CP at 3395-4000. Steadfast and Travelers opposed the presentation of the judgment, in part because it set the post-judgment interest rate at 12%. CP at 3401-09; 3477-87. Steadfast and Travelers requested that the trial court set an interest rate at the tort rate pursuant to RCW 4.56.110(3), given that the thrust of the underlying action pertained to the claims of misrepresentation and fraud in connection with the POS. *Id.* The court rejected the insurers' argument and approved the post-judgment interest rate at 12%. CP at 3729-32. Travelers moved for reconsideration, arguing *inter alia* that the 12% interest rate did not control given the trial court's conclusion that the settlement was unreasonable, and Steadfast joined the motion. CP at 3733-3744, 3746-3749. The trial court denied the motion for reconsideration. CP at 3754-55. Steadfast now respectfully appeals this decision. CP at 3767-68.³

E. Litigation of the Claims

In the complaint, the Association asserted the following causes of action: (1) declaratory judgment, (2) breach of implied warranties under the Washington Condominium Act, (3) failure to deliver valid public statement offering, (4) misrepresentations and material omission, (5)

³ The Association did not appeal the trial court's ruling that the Settlement was unreasonable.

fraudulent concealment, (6) breach of fiduciary duty, (7) violation of the CPA, (8) relief from fraudulent transfers, (9) improper winding up of dissolved LLC and appointment of receiver.⁴ CP at 4-28. Notwithstanding the multiple causes of action, the Association's claim in essence stemmed from the contentions that the building envelope was defective and that the defendants failed to advise the prospective unit purchasers—either negligently or intentionally—of the defective conditions.

The predominant liability theories were tort claims based on the marketing and sale of the units. With respect to these claims, the allegations generally fell into two categories. First, the Association claimed that the inspection report, focusing on the condition of the building envelope, minimized or understated the nature of the conditions at the subject property. For example, the complaint alleged:

6.8 In preparing or assisting in the preparation of the public offering statement for the Project, Declarant, Declarant Alter Egos, Declarant's Principals, and/or DOE DECLARANT AGENTS 1-5 intentionally and/or negligently failed to include a report or statement that complies with RCW 64.34.415(1)(a). Specifically, the report included with the public offering statement fails to meet statutory requirements, and is deceptive and misleading in that it: (a) does not disclose material

⁴ Early on, the trial court granted summary judgment on the first cause of action, agreeing with the Association that the defendants were not able to disclaim any of the warranties under the WCA. CP at 206- 208. The Association voluntarily dismissed its claim for improper winding up of the LLC. CP at 665. Finally, there was a tenth claim, for breach of contract/warranty, but it was not against AFECO and AFED. CP at 25.

defective conditions that were reasonably ascertainable by an independent, licensed architect or engineer undertaking a reasonable, good-faith examination of the Project's common elements, and/or (b) materially misrepresents the condition of the Project's structural and/or mechanical and/or electrical systems, and/or (c) does not report on the condition of all structural, mechanical and electrical systems material to the use and enjoyment of the Project.

CP at 16. Second, the Association alleged that the reserve study was misleading. To this end, the complaint alleged:

6.3 In order to keep assessments low at the Project and thereby facilitate unit sales, Declarant, Declarant Alter Egos, Declarant's Principals, and DOE DECLARANT AGENTS 1-5 conspired to misrepresent in the public offering statements, and in the course of unit sales, the amount of reasonably required replacement reserves and repair costs for the Project common elements.

6.4 In particular, and without limitation, Declarant, Declarant Alter Egos and Declarant's Principals deliberately refrained from informing Marx Okubo, which they had hired to prepare a "Reserve Study" for the public offering statement, of the presence of known, widespread, serious construction defects and damage at the Project. As a result, the "Reserve Study" ultimately produced by Marx Okubo and included in the public offerings statement, and its reserve contribution estimates, were grossly inaccurate.

CP at 15. Other parts of the complaint asserted these factual contentions in conjunction with one another:

7.3 Furthermore, Declarant, Declarant Alter Egos, Declarant's Principals, DOE DECLARANT AGENTS 1-5, and DOE SALES AGENTS 1-10 represented existing facts concerning the physical condition of the Project and the cost to maintain it in the public offering statement, which representations were material to the purchase of the units. Those representations falsely characterized or failed to

disclose the true physical condition of the Project, and understated the costs to maintain it. Declarant, Declarant Alter Egos, Declarant's Principals, DOE DECLARANT AGENTS 1-5, and DOE SALES AGENTS 1-10 knew that these representations were false, or were ignorant of their truth, and intended that unit purchasers at the Project rely on those representations. For their part, unit purchasers were ignorant of the false character of these representations in the public offering statement regarding the physical condition of the Project and the cost to maintain it, and relied on the false representations in purchasing units (as was their right under the Condominium Act), to their consequent damage.

* * *

8.5 Declarant, Declarant Alter Egos, RICHARD BELL, JOHN J. ROBERTSON, TORY LAUGHLIN-TAYLOR and DOE DECLARANT BOARD MEMBERS 1-10 failed to disclose to the Association the presence of defects, physical hazards, and understatement of the operating and reserve budgets, and failed to act reasonably in response to these facts ...

CP at 18-20. Moreover, in its claim for a violation of the CPA, the Association characterized these same facts as constituting “unfair or deceptive practices.” CP at 22.

With respect to the statutory claims, the Association alleged that the defendants breached the WCA’s implied warranties of suitability—that the units and common elements of the Project were suitable for the ordinary uses of real estate of its type—and quality construction—that improvements made or contracted for were free of defective materials and constructed in a workmanlike manner. CP at 10. Although the complaint

alleged facts pertaining to both of these warranties, early factual discovery made clear that the only warranty potentially applicable was that of suitability. For conversion projects, the quality construction warranty attaches only with respect to “improvements made or contracted for” by the developer. RCW 64.34.445(2). In this conversion project, defendants made no improvements on the buildings exteriors, where the “construction defect” allegations were focused. CP at 1264. The Association essentially conceded this argument, focusing on its allegation that there were latent physical hazards that reduced the useful life and structural integrity of the building’s components in breach of the warranty of suitability. *See, e.g.*, CP at 557-59.

As the litigation progressed, it became evident that the warranty theory, for reasons described below, was not viable. *See infra*, section C. 2. a and b. Accordingly, at the time of the Settlement, the Association’s only avenue for liability was its tort claims. *See infra*, section C. 2. c.

V. ARGUMENT

A. Standard of Review

This appeal presents issues of statutory interpretation and construction of a settlement agreement, both questions of law, which this court reviews de novo. *Aguirre v. AT & T Wireless Services*, 118 Wn. App. 236, 240, 75 P.3d 603 (2003).

B. The Post-Judgment Interest Rate of 12% was Approved by the Trial Court in Error and Should be Reversed

1. The post-judgment interest rate is governed by statute

The interest rate is controlled by Washington statute. RCW 4.56.110 sets forth four categories of judgments: (1) breach of contract where an interest rate is specified; (2) child support; (3) tort claims; and (4) all other claims. *Woo v. Fireman's Fund Ins. Co.*, 150 Wn. App. 158, 165, 208 P.3d 557 (2009). It provides, in relevant part:

Interest on judgments shall accrue as follows:

(1) Judgments founded on written contracts, providing for the payment of interest until paid at a specified rate, shall bear interest at the rate specified in the contracts: PROVIDED, That said interest rate is set forth in the judgment.

(2) All judgments for unpaid child support ... shall bear interest at the rate of twelve percent.

(3)(a) ...

(b) Except as provided in (a) of this subsection, judgments founded on the tortious conduct of individuals or other entities, whether acting in their personal or representative capacities, shall bear interest from the date of entry at two percentage points above the prime rate, as published by the board of governors of the federal reserve system on the first business day of the calendar month immediately preceding the date of entry. In any case where a court is directed on review to enter judgment on a verdict or in any case where a judgment entered on a verdict is wholly or partly affirmed on review, interest on the judgment or on

that portion of the judgment affirmed shall date back to and shall accrue from the date the verdict was rendered.

(4) Except as provided under subsections (1), (2), and (3) of this section, judgments shall bear interest from the date of entry at the maximum rate permitted under RCW 19.52.020 on the date of entry thereof. In any case where a court is directed on review to enter judgment on a verdict or in any case where a judgment entered on a verdict is wholly or partly affirmed on review, interest on the judgment or on that portion of the judgment affirmed shall date back to and shall accrue from the date the verdict was rendered. The method for determining an interest rate prescribed by this subsection is also the method for determining the "rate applicable to civil judgments" for purposes of RCW 10.82.090.

RCW 4.56.110(1) provides contracting parties with the freedom to choose varying interest rates depending on their individual circumstances. *Jackson v. Fenix Underground, Inc.*, 142 Wn. App. 141, 147, 173 P.3d 977 (2007). Thus, once parties have agreed to settle a tort claim, the foundation of the judgment is the written contract not the underlying allegations of tortious conduct. *Jackson*, 142 Wn. App. at 146. However, the settlement of tort liability by written agreement does not automatically set the judgment interest rate under RCW 4.56.110(1). See *Unigard Ins. Co. v. Mutual of Enumclaw Ins. Co.*, 160 Wn. App. 912, 926, 250 P.3d 121 (2011).

2. RCW 4.56.110(1) does not apply

Citing *Jackson v. Fenix Underground, Inc.*, 142 Wn. App. 141, 173 P.3d 977 (2007) to the trial court, the Association asserted that RCW 4.56.110(1) applied because “the Settlement Agreement stated that the interest rate on the judgment would be 12%.” CP at 3591-92. The trial court apparently agreed.

The reliance on *Jackson* is misplaced because the Appendices’ proposed judgments never became operative given the determination that the Settlement was unreasonable. In *Jackson*, the interest rate was set forth in the four corners of the settlement agreement together with the \$275,000 settlement amount. *Id.* at 143. The trial court found that the settlement was reasonable following a reasonableness hearing. *Id.* at 144. In this respect, the court held that both the interest rate and the \$275,000 stipulated judgment amount had been deemed reasonable under RCW 4.22.060:

[RCW 4.22.060] provides for a hearing on the issue of the reasonableness of the “amount to be paid.” Scottsdale contends that the “amount to be paid” in this case was \$275,000 because the arguments at the hearing revolved around whether this principal sum was reasonable in light of the evidence of liability and damages, not whether the interest rate was reasonable....

... Because the interest is part of the “amount to be paid” on a contract implementing a settlement of a tort suit, the court does not have authority to adjust the specified interest

rate once the court has determined that the amount to be paid is reasonable....

Id. at 146-147. In view of this finding, the Court of Appeals held that the agreed-upon interest rate was binding on the insurance company, concluding that insurance company's argument was nothing more than a collateral attack on the reasonableness determination itself. *Id.* at 146-47.

Here, the opposite occurred: The trial court rejected the Settlement because it was unreasonable, and the court then set a new amount as reasonable. As a result, the Settlement – inclusive of the settlement amounts and the interest rate tied to them – never became binding on Steadfast.⁵ In short, the Settlement's \$8.2 million settlement amount and the Appendices' 12% interest rates never became operative vis-à-vis Steadfast.

Notably, the respondents had an option in the aftermath of the trial court's ruling: They could have executed a new settlement agreement based on the principal amount that the trial court had found to be reasonable. *See Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.*, 137 Wn. App. 810, 820-822, 156 P.3d 240 (2007); *Howard v. Royal Spec. Underwriting*, 121 Wn. App. 372, 376-377, 89 P.3d 265

⁵ The settlement remained binding as between AFECO, AFED and the Association; it was not binding as to Steadfast. *See Meadow Valley Owners Ass'n v. St. Paul Fire & Marine Ins. Co.*, 137 Wn. App. 810, 820-822, 156 P.3d 240 (2007).

(2004), *review denied*, 153 Wn.2d 1009 (2005). But, for whatever reason, they failed to take this course.

Moreover, it should be remembered what is occurring here: The settlement's sole purpose was to set up damages claims against Steadfast and Travelers in a subsequent insurance bad faith action.⁶ *As such, AFECO and AFED entered into a settlement agreement that they would never pay.* The trial court recognized as much in its oral ruling, concluding that "the amount of settlement was affected by the fact that the settling party did not have any direct interest in the amount. In other words, it was not directly affected by the amount that would have to be paid, and that did affect the nature of the negotiations in the amount." 12/10/2010 RP at 37:12-19. The same is true for the 12% interest on that settlement amount: It was the product of AFECO's and AFED's indifference.

Finally, per *Jackson*, the purpose underlying Section 1 is to allow "contracting parties with the freedom to choose varying interest rates

⁶ See *Werlinger v. Warner*, 126 Wn. App. 342, 350-351, 109 P.3d 22 ("the sole purpose of the covenant judgment [is] to serve as the presumptive measure of damages in a separate bad faith lawsuit."), *review denied*, 155 Wn.2d 1025 (2005). The bad faith lawsuit is currently going forward against Steadfast in federal court. See *Travelers Property and Cas. Co. v. A.F. Evans Company, Inc., et al.*, U.S. District Court for the Western District of Wash. No. CV-10-01110.

depending on their individual circumstances.” *Jackson* at 147. But, this purpose is absent here because the contracting parties – AFED and AFECO – will never pay the interest. While contracting parties may have the freedom to decide what they themselves will pay in interest, they do not have the freedom to choose an interest rate and then force a third party, such as Steadfast, to pay it where, as here, the Settlement was deemed to be unreasonable.

In summary, unlike in *Jackson*, the trial court found the Settlement to be unreasonable. As a result, this is not a situation where the parties specified the specific interest rate, as required by RCW 4.56.110(1), that was binding as to Steadfast. Accordingly, the inquiry must focus on which of the remaining statutory categories is appropriate for setting the post judgment interest rate. *Cf. Unigard Ins. Co. v. Mutual of Enumclaw Ins. Co.*, 160 Wn. App. at 926 (holding that *Jackson* did not control where the settlement at issue did not specify an interest rate).

C. The predominant character of this judgment was founded on tortious conduct and RCW 4.56.110(3) should therefore apply

1. Mixed judgments are subject to a single post-judgment interest rate

A “mixed judgment,” a judgment based on more than one type of claim, is subject to only one interest rate. *Woo*, 150 Wn. App. at 164. In determining the appropriate interest rate, a court should examine the

component parts of the judgment, determine what the judgment is primarily based on, and apply the appropriate category. *See Woo*, 150 Wn. App. at 173. In fact, this court has specifically rejected the idea that the “catch-all” interest rate in subsection (4) applies when a “mixed-judgment” is at issue. *Woo*, 150 Wn. App. at 173-74. “Given that the legislature has expressly provided for different rates of interest on judgments that depend on the nature of the underlying claim or damages, it follows that we should examine the aspects of the judgment in this case to determine what rate applies.” *Woo*, 150 Wn. App. at 170. Where, as here, the judgment concededly stems from multiple liability theories, the task of this court is to analyze the predominant character of the judgment. *Woo*, 150 Wn. App. at 172-173.

2. **Based on a subjective and objective assessment of the claims being litigated at the time of negotiations, the Settlement undisputedly resolved the tort-based claims**
 - a. **Counsel did not believe the warranty claims were viable; they did not, therefore, drive the settlement**

Because this case never went to a jury, the merits of the individual claims were never fully litigated. However, a review of defense counsel’s assessment of the warranty claim heading into settlement negotiations, as well as a substantive analysis of the claim’s merits, make clear that the settlement amount was not founded on the warranty of suitability claim.

Per Stephen Todd, who was defense counsel for one of the individual defendants, exposure to damages from the warranty claim was minimal:

10 We felt quite strongly that the warranty of
11 suitability claim was very weak as to all defendants.

12 Q Did you think that this case had a potential for a
13 defense verdict as to all defendants?

14 A This case was unique in that the declarant did not
15 improve any aspect of the exterior of the project which
16 was the subject of the construction defect claims. So
17 the warranty of suitability argument applied equally to
18 all defendants....

* * * *

16 And because these units were suitable for a
17 residence, nobody's ever moved out of them, they have
18 never been red tagged, they've never had structural
19 deficiencies, there's no life safety issues identified,
20 in our opinion the warranty of suitability claim was a
21 very weak claim.

CP at 2799; 2836. Indeed, the driving force of the settlement was not damages from the breach of warranty claims, but those damages caused by the understated reserves:

12 A The -- you had an \$8 million claim which
13 is based on a cost of repairing construction defects.
14 Those would be the damages flowing from a violation of
15 the implied warranty. In this case the implied warranty
16 was only the implied warranty of suitability.

17 So the -- in our opinion, the damages flowing from a
18 breach of the implied warranty of suitability were zero.

19 Mr. Stein in argument said, "we're not asking
20 for 8 million for breach of the implied warranty of

21 suitability. We're asking for 8 million because the reserves
22 are understated and that's the amount that would have to be
23 added to the reserves to pay for these repairs."

CP at 2851. Per Todd, the Association's counsel was abandoning the theory:

6 A Well, during the course of oral argument on an earlier
7 motion practice, the association's attorney, Jerry Stein,
8 made some pretty, to my mind, important comments to the
9 effect that this was not a breach of warranty case, that
10 they were backing off the warranty of suitability
11 argument which is usually -- well, the implied warranty
12 of quality is the touchstone of all condo cases,
13 construction defect cases involving condominiums.
14 In that argument he refocused to a claim that the
15 reserves for the association were understated. ...

CP at 2801.

Avi Lipman, counsel for AFECO, echoed the conclusion that the plaintiff's warranty of suitability theory "finds no support under Washington law[.]" CP at 3189. Most telling, the consensus among defense counsel was that the trial court would give an instruction like that in *Balaton Condo. Ass'n. v. Balaton Condo., LLC*, No. 07-2-14061-1SEA, a similar condominium conversion lawsuit in King County from 2009. CP at 2783; 3026-27; 3190. In that case, King County Superior Court Judge Julie Spector gave a jury instruction regarding the implied warranty of suitability, stating that although it is not necessary that the defects be so serious that they force the occupant to move out, the defects must at least

present a substantial risk. CP at 3232. The jury in *Balaton* found almost 100% in favor of the associations for claims of defective improvements but awarded virtually nothing for defects alleged in non-improved areas under the implied warranty of suitability. CP at 3173. Given the outcome in *Balaton*, defense counsel felt strongly that the Association's claim as to the warranty of suitability would not generate a jury award close to the Association's demand. CP at 2784; 3191. Thus, heading into settlement negotiations it was clear the warranty claim was of little, if any, value.

b. Defense Counsel's assessment of the warranty claim was reasonable given that it was unlikely to succeed under a proper application of Washington law

Before the trial court, the Association argued that by the default judgment, Spinnaker's warranty liability under the WCA was established as a matter of law. CP at 3583. The Association therefore claimed that "[b]y extension, the other corporate defendants were at substantial risk of being held liable for the full amount." *Id.* However, there was a strong consensus among defense counsel that the default judgment was entered in error and that this would be reversed on appeal.⁷ CP at 3188. Indeed, a

⁷ In his mediation letter, Avi Lipman stated: "Defense counsel agree there is a good possibility that the Court of Appeals will reverse Judge Gonzalez's decision to issue a default judgment against Spinnaker, which the court did in front of numerous and substantial factual disputes regarding the scope and measure of damages." CP at 3188.

closer look at the merits reveals that the warranty of suitability claim would not have succeeded on this set of facts.

As noted above, the warranty of suitability is simply an implied warranty that a unit and common elements “are suitable for the ordinary uses of real estate of its type[.]” RCW 64.34.445(2). This requires that suitability be analyzed in connection with other buildings of similar age and construction. “The implied warranty of habitability in Washington is a limited one,” and “grant[s] recovery to the first intended occupants for egregious, fundamental defects in homes which, as the name of the warranty indicated, render the house unfit to be lived in.”⁸ *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406, 415-16, 745 P.2d 1284 (1987). There is no requirement that a homeowner must have moved out in order to prevail on an implied warranty of suitability; however, the defects may not be trivial or aesthetic. *Westlake View Condominium Ass'n v. Sixth Avenue View Partners, LLC*, 146 Wn. App. 760, 770, 193 P.3d 161 (2008). Rather, if the violations present a

⁸ The WCA does not define “suitability,” but the Legislature’s comment to the Act states that “[t]he warranty of suitability under this Act is similar to the warranty of habitability.” Official comments to WCA p. 54 (Comment 3 to RCW 64.34.445). Washington case law also equates the implied warranty of suitability to the implied warranty of habitability. *Park Ave. Condo Ass'n v. Buchan Devs., LLC*, 117 Wn. App. 369, 382, 71 P.3d 692, 698 (2003) (“The warranty of habitability addresses whether a structure is reasonably fit for use as a residence, and is therefore like the WCA warranty of suitability.”).

substantial risk of future danger, the implied warranty is a viable claim. *Id.* at 771-72.

In cases where the homeowners have prevailed on the warranty of suitability, the facts reveal extremely substantial defects where the defects present a substantial risk of future danger. *Westlake*, 146 Wn. App. at 771-72 (finding that persistent leaking, siding decay, and reoccurring mold at the window sills were neither trivial nor merely aesthetic defects); *see also Atherton Condominium Apartment–Owners Assoc. Bd. of Directors v. Blume Development Co.*, 115 Wn.2d 506, 522, 799 P.2d 250 (1990) (characterizing the inferior stucco substitute, which did not meet fire resistivity standards, as a violation concerning fundamental fire safety provisions) and *Burbo v. Harley C. Douglass, Inc.*, 125 Wn. App. 684, 106 P.3d 258 (2005) (defects included cracks in the foundation, wide enough to see daylight through, and water intrusion into the living room, damaging walls, flooring, carpeting, and personal property).

In contrast, the defects to the Esplanade’s envelope system, while in need of repair, did not create a *substantial risk of future danger*. According to the Association’s expert, Arthur Schroeder, there was water penetration and water damage to the underlying building components, but no water intrusion into the interior living spaces. CP at 60-61; *Compare Westlake and Burbo*. In his declaration, Mr. Schroeder stated:

...the building paper system, windows and flashing systems were not suitable for their ordinary purpose of protecting the sheathing and framing from water intrusion and damage. These defects are present at numerous locations and repairs will require a full strip re-clad of the buildings and extensive replacement of exterior sheathing. Unless and until these defective components are repaired, water intrusion will continue and the wall sheathing will become further damaged. Such progressive damage will eventually result in the substantial structural impairment of the exterior sheathing's ability to resist lateral load caused by earthquakes and high wind loads. Additionally the leakage, if not stopped, will cause continuing and worsening decay in the exterior framing of the buildings which will result in safety concerns.

CP at 61. But this position—that warranty of suitability somehow applies to each individual building component—was derived from plaintiff's counsel and has no basis under Washington law. CP at 1725-26. In fact, when asked whether it was his opinion that the Esplanade was not fit for habitation, Mr. Schroeder conceded that it was not yet at that point. *Id.*

Even taking the Association's best evidence of common area defects, a substantial risk of future danger is still not present. The defects—water damage to the building envelope and lack of adequate water proofing—were several steps away from becoming the type of egregious defects that pose a significant threat to habitability. Compared to the imminent threat of danger in *Westlake*, *Atherton*, and *Burbo*, the Esplanade's defects—admittedly in need of repair—did not render the entire building unsuitable for its ordinary use.

The warranty of suitability, contemplated to protect homeowners in the context of a condominium conversion, is not a warranty of perfection. Indeed, the WCA requires that the public statement offering for a conversion condominium include a report detailing the present condition of structural components, as well as a statement of each article's useful life, and a list of outstanding notices of uncured violations of building codes or regulations. RCW 64.34.425(1). And while the declarant has a duty to cure building code violations, the declarant can avoid that duty if the buyer waives the right to a cure in writing. RCW 64.34.415(1)(d). Thus, the statute implicitly accepts certain building code violations and defects as suitable in the context of condominium conversions. The need to make repairs, even immediate repairs, does not necessarily render a complex unsuitable for its ordinary uses.

In sum, defense counsel's subjective belief that the warranty of suitability claims was weak should be well-taken. Applying the proper standard, it is unlikely the Association's claim would have resulted in a favorable judgment. Accordingly, defense counsel could not have, in good faith, settled the lawsuit on the basis of this claim.

c. The remaining claims, upon which the Settlement was based, sounded in tort

Without a viable warranty of suitability claim, the Association was forced into its torts-based theory in an effort to recover cost of repair damages as the proximate cause of the defendants' misrepresentations and omissions. Although defense counsel believed there to be a number of defenses to the tort claims—including the plaintiff's ability to prove causation and damages—the defendants had lost a number of summary judgment motions on tort-based issues. *See* CP at 768-770 (Order Denying John Robertson and Tory Laughlin-Taylor's Motion for Summary Judgment Dismissal of Breach of Fiduciary Duty Claim) *and* CP at 771-73 (Order Denying Evans Defendants' Motion for Partial Summary Judgment re Economic Losses and Disclosure). Moreover, there were several other pending summary judgment motions on tort-based issues, including Evans Defendants' Motion for Partial Summary Judgment re Fraudulent Concealment and Evans Defendants' Motion for Partial Summary Judgment re Justifiable Reliance. CP at 866-872 and 907-915.

Simply put, the tort claims were front and center of the litigation. While the parties litigated these claims, as well as the alter-ego theory of liability for these claims, the warranty claims lay dormant. As the focus of the litigation was squarely on the defendants' alleged misrepresentations

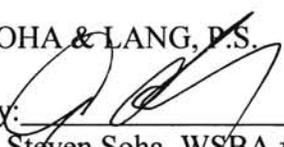
and omissions, the predominant basis for the Settlement was, accordingly, the resolution of the Association's tort-based claims.

VI. CONCLUSION

All the causes of action seriously driving the settlement negotiations arise from the same basic factual contentions, the negligent and/or fraudulent failure to identify construction defects in the original sale materials for the property. Based on the foregoing, it is clear that the ultimate judgment in this matter has its basis in "tortious conduct." Moreover, the parties did not agree to a 12% interest rate in the Settlement. As such, the tort rate set forth in RCW 4.56.110(3)(b) should be applied to the final judgment amount. Steadfast respectfully asks this Court to reverse the trial court's error and remand to institute the tort-based interest rate of 5.25%.⁹

DATED this 26th day of July, 2012.

SOHA & LANG, P.S.

By: 

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⁹ The prime rate at the time of the presentation of the judgment was (and still is) 3.25%. CP at 3476.

CERTIFICATE OF SERVICE

I am employed in the County of King, State of Washington. I am over the age of 18 and not a party to the within action; my business address is SOHA & LANG, PS, 1325 Fourth Avenue, Suite 2000, Seattle, WA 98101.

On July 30, 2012, I served a true and correct copy of the foregoing

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Executed on this 30th day of July, 2012, at Seattle, Washington.

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


Rachelle M. Darby
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