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IN THE SUPREME COURT OF THE STATE OF IDAHO

THE GREASE SPOT, INC.,

Plaintiff/Respondent,

vs.

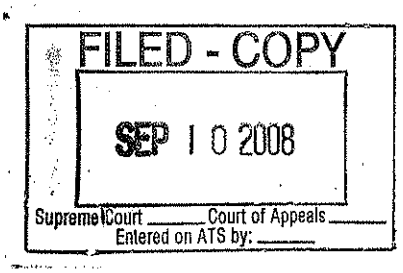
RICHARD and SHERRY HARNES, husband and wife,

Defendants/Appellants,

and BAKER COMMODITIES, INC., a Delaware Corporation, and JOHN DOES 1-10,

Defendants.

Supreme Court Docket No. 35321



APPELLANTS' BRIEF

Appeal from the District Court of the
First Judicial District for Kootenai County

Honorable Charles W. Hosack, District Judge, Presiding

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I. STATEMENT OF THE CASE

A. Nature of the Case

This case involves the prevailing defendants/appellants Harnes' (Harnes) application for attorney fees incurred before, during and after Harnes successfully obtained an order compelling arbitration of the plaintiff/respondent The Grease Spot, Inc.'s (Grease Spot) civil action against them. This case asks this Court to examine the jurisprudence under Idaho Code § 12-120(3) in relationship to Idaho Code § 41-1839 and to construe these two fee-shifting statues similarly to authorize an award of attorney fees despite the referral of the dispute to arbitration.

B. Procedural History

This action was for breach of a contract for the purchase and sale of The Grease Spot, Inc. based on the asserted violation of a non-competition clause in the agreement. R., pp. 1-25. The complaint also asked for relief based on the breach of the covenant of good faith and fair dealing, for unjust enrichment, violation of the trade secrets act arising out of the breach of the contract and for injunctive relief arising out of the breach of the contract. Grease Spot instituted this action on July 5, 2005. Grease Spot prayed in part for its attorney fees pursuant to Idaho Code § 12-120. R, p. 12. Harnes moved to dismiss and compel arbitration based on an arbitration provision in the contract. The arbitration provision was silent on the question of attorney fees. R., p. 23. Grease Spot objected. After a hearing and briefing, the trial court entered its order compelling arbitration and staying litigation on March 20, 2006. R., p. 33-36.

The matter was then arbitrated at a hearing before the Hon. Ron Schilling on March 20 and 21, 2007. Judge Schilling issued his decision on June 25, 2007. R., pp. 42-50. The arbitration award was confirmed by the court and judgment in behalf of Harnes was entered on October 1, 2007. R., pp. 51-54. The judgment did not contain a Rule 54(b) certificate. Harnes made a timely application for attorney fees and costs on October 11, 2007. R., pp. 55-68. Grease Spot objected and moved to disallow the Harnes' application. R., pp. 68-76. After a hearing held December 6, 2007, the trial court entered its Memorandum Decision and Order on January 22, 2008. R., pp. 77-81. The Grease Spot and the co-defendant Baker Commodities stipulated to an Order of Dismissal with Prejudice of the claims between them, which was entered March 27, 2008. R., pp. 82-83. That order made final the prior judgment between the Grease Spot and Harnes. A timely notice of appeal was filed May 8, 2008, R., pp. 84-87 and an amended notice of appeal showing service on the court reporter was filed June 4, 2008. R., pp. 88-91.

C. Statement of Facts

The facts relevant to this appeal are contained in the transcript of the hearing on December 6, 2007 and the trial court's Memorandum Decision and Order. The trial court denied Harnes' application for attorney fees incurred before and during arbitration and in obtaining confirmation of the arbitration award and entry of judgment, except for those attorney fees the trial court felt were attributable to the issue on which Harnes prevailed in the civil litigation - the motion to compel arbitration.

II. ISSUES ON APPEAL

Whether the trial court erred in denying most of Harnes' attorney fees incurred in the civil action before the matter was referred to arbitration and all of Harnes' attorney fees after it returned?

Whether the trial court erred in denying Harnes' attorney fees in a suit to recover in a commercial transaction where the matter is referred to arbitration, the arbitration agreement is silent on the question of attorney fees, and the arbitrator makes no decision to grant or deny attorney fees to the prevailing party?

Whether Harnes are entitled to attorney fees on appeal?

III. ARGUMENT

1. The standard of review.

The interpretation of statutes is a question of law over which this Court exercises free review. *Paolini v. Albertson's, Inc.*, 143 Idaho 547, 149 P.3d 822, 824 (2006); *McLean v. Maverick Country Stores, Inc.*, 142 Idaho 810, 813, 135 P.3d 756, 759 (2006).

The Court construes the statute to give effect to the legislative intent, based on the plain, ordinary meaning of the words used. *Paolini*; *Carrier v. Lake Pend Oreille School Dist. # 84*, 142 Idaho 804, 807, 134 P.3d 655, 658 (2006). Statutes that are in pari materia must be construed together to effect legislative intent. Statutes are in pari materia if they relate to the same subject. *Paolini*; *City of Sandpoint v. Sandpoint Indep. Highway Dist.*, 139 Idaho 65, 69, 72 P.3d 905, 909 (2003).

2. Section 12-120(3) is a fee-shifting statute in pari materia with Section 41-1839.

Idaho Code § 12-120(3) is substantive law, not a procedural right. *Myers v. Vermaas*, 114 Idaho 85, 753 P.2d 296, 297-99 (Ct.App. 1988); *Griggs v. Nash*, 116 Idaho 228, 775 P.2d 120, 126-27 (1989). Idaho Code § 41-1839 is also substantive law, and amendments to it have only been given retroactive effect by specific legislative enactment. 1996 Idaho Sess. Laws 1307, 1308, 1309; *J.R. Simplot Co. v. Western Heritage Ins. Co.*, 132 Idaho 582, 977 P.2d 196, 198 (1999); see also *Union Warehouse and Supply v. Illinois R.B. Jones, Inc.*, 128 Idaho 660, 669, 917 P.2d 1300, 1309 (1996) (noting the retroactive effect of the 1996 amendment).

Idaho Code § 12-120(3) shifts the attorney fee responsibility between the parties in civil actions involving commercial transactions and allocates the cost of using the court system to resolve disputes in a facially neutral manner. It is not a penalty. *Sanders v. Lankford*, 134 Idaho 322, 1 P.3d 823827-28 (Ct.App. 2000).

Likewise, Idaho Code § 41-1839 has the purpose to guarantee that insureds who are forced to litigate performance of the insurance contract receive the full amount due undiminished by the costs associated with litigation. Section 41-1839 is not a penalty but an additional sum rendered as just compensation. *Barber v. State Farm Mut. Auto. Ins. Co.*, 129 Idaho 677, 931 P.2d 1195, 1200 (1997); *Emery v. United Pacific Ins. Co.*, 120 Idaho 244, 815 P.2d 442, 445 (1991); *Halliday v. Farmers Ins. Exch.*, 89 Idaho 293, 404 P.2d 634 (1965). Section 41-1839 is an implied term in the insurance contract and modifies the general

American Arbitration Association rule that the parties must bear equally all expenses of arbitration, except those associated with the presentation of witnesses. *Emery*, 120 Idaho at 247; 815 P.2d at 445. It is not, however, an implied term that will support an independent action for its enforcement. *Wolfe v. Farm Bureau Ins. Co.*, 128 Idaho 398, 913 P.2d 1168, 1175 (1996).

The Idaho Court of Appeals has asked but not answered the question whether Idaho Code § 12-120(3) becomes an implied term in a contract involving a commercial transaction. *Storrer v. Kier Const. Corp.*, 129 Idaho 745, 932 P.2d 373, 375 (Ct.App. 1997). In *Storrer*, the Idaho Court of Appeals did hold that Idaho Code § 12-120 will not support an independent action for its enforcement. *Id.*, 129 Idaho at 747, 932 P.2d at 375.

Section 41-1839(4) states that it and Idaho Code § 12-123 provide the exclusive remedy for the award of statutory attorney fees in disputes between insureds and insurers arising under any policy of insurance and that Idaho Code § 12-120 does not apply to those disputes. See *Hayden Lake Fire Protection Dist. v. Alcorn*, 141 Idaho 307, 109 P.3d 161, 166-67 (2005) (recognizing rule as limited to disputes between insurer and insured –other commercial transaction disputes within the scope of Idaho Code § 12-120(3)) and *Primary Health Network, Inc. v. State*, 137 Idaho 663, 52 P.3d 307, 314 (2002) (awarding the prevailing party attorney fees under Section 12-120 in a suit over a commercial transaction involving insurance but not a dispute between an insurer and an insured).

The amendment to add subsection 4 to Idaho Code § 41-1839 was an apparent

legislative response to *Continental Cas. Co. v. Brady*, 127 Idaho 830, 907 P.2d 807, 812-13 (1995), in which the Idaho Supreme Court had awarded statutory attorney fees to the insurer under the facially neutral provisions of Idaho Code § 12-120(3). *J.R. Simplot Co. v. Western Heritage Ins. Co.*, 132 Idaho 582, 977 P.2d 196, 198 (1999).

Other than the distinction that Section 41-1839 is a one-way street unless Section 12-123 is satisfied, it meets the same criteria as Section 12-120(3): it is substantive, it is not punitive, and it allocates the expense of litigation in specific circumstances. Thus, Section 12-120(3) and Section 41-1839 are in pari material.

3. Under Section 41-1839, an insured is entitled to an award of attorney fees, including attorney fees incurred in the course of arbitration between the insured and the insurer, provided that two conditions are met.

In *Emery v. United Pacific Ins. Co.*, 120 Idaho 244, 815 P.2d 442, 444-45 (1991), the Court affirmed the trial court's award of attorney fees to the insured under Section 41-1839 incurred during the entire litigation process, including the arbitration proceedings. That Idaho Code § 7-910 limited the arbitrator's authority to award attorney fees and the American Arbitration Association rules did not authorize an attorney fee award did not limit the authority of the district court to do so pursuant to Idaho Code § 41-1839. The Court reasoned that Idaho Code § 41-1839 became an implied provision of the insurance contract, citing *Pendlebury v. Western Casualty & Sur. Co.*, 89 Idaho 456, 406 P.2d 129 (1965).

The insured's right to attorney fees in arbitrations with the insurer was not absolute,

however. No right to attorney fees accrued under Section 41-1839, unless the insured had been compelled to bring a suit to obtain an amount justly due under the policy of insurance. Although Section 41-1839 was an implied provision of the insurance contract it would not support an independent action for fees by the insured against the insurer. *Wolfe v. Farm Bureau, Ins. Co.*, 128 Idaho 398, 913 P.2d 1168, 1173-1176 (1996).

The conditions for an award of attorney fees under Section 41-1839 were:

> (1) [the insured] has provided proof of loss as required by the insurance policy; (2) the insurance company fails to pay an amount justly due under the policy within thirty days of such proof of loss; and (3) the insured "thereafter" is compelled to bring suit to recover for his loss.

Id., quoting from *Hansen v. State Farm Mut. Auto. Ins. Co.*, 112 Idaho 663, 671, 735 P.2d 974, 982 (1987).

In *Martin v. State Farm Mut. Auto. Ins. Co.*, 138 Idaho 244, 61 P.3d 601, 604-05 (2002), the Idaho Supreme Court abandoned the third "compulsion" prong of the Hansen test, disapproving *Anderson v. Farmers Insurance Co.*, 130 Idaho 755, 759, 947 P.2d 1003, 1007 (1997). See *Parsons v. Mutual of Enumclaw Ins. Co.*, 143 Idaho 743, 152 P.3d 614, 617-18 (2007). So to the extent that compulsion presented a justification to award attorney fees against insurers in civil actions referred to arbitration, it no longer does so.

4. Under Section 12-120(3) the same analysis applies. Where a suit is over a commercial transaction, the prevailing party is entitled to an award of attorney fees. This entitlement to attorney fees in the prevailing party applies whether the contract constituting the commercial

transaction has an attorney fee provision. This entitlement to attorney fees should apply even though the civil action is referred to arbitration on the motion of a party.

Storrer v. Kier Const. Corp., 129 Idaho 745, 932 P.2d 373, 376 (Ct.App. 1997), *Barbee v. WMA Securities, Inc.*, 143 Idaho 391, 146 P.3d 657, 661 (2006) and *Moore v. Omnicare*, 141 Idaho 809, 118 P.3d 141, 149 (2005) all involved applications for attorney fees or suits for attorney fees after the completion of arbitration and are inapposite. In *Storrer*, the Court of Appeals affirmed the trial court's decision that a request for attorney fees through an application for confirmation of an arbitration award was not a civil action. A party claiming attorney fees under Idaho Code § 12-120(3) must prevail in a civil action. The court noted that the commercial transaction had been decided in arbitration, not in a civil action. 129 Idaho at 747, 932 P.2d at 375. In *Barbee,* the Court rejected an action for attorney fees pursuant to Idaho Code § 30-1446 subsequent to an arbitration award. In *Moore*, the Court overruled the arbitrator's award of attorney fees where the Asset Purchase Agreement required that the parties bear their own costs and fees of arbitration, including specifically attorney fees. Compare *Garner v. Bartschi*, 139 Idaho 430, 80 P.3d 1031, 1039 (2003) (arbitration agreement specifically awarded attorney fees to prevailing party). The purchase and sale agreement in this case was silent on the issue of attorney fees.

In this case, Grease Spot filed a civil action involving a commercial transaction and prayed for relief including attorney fees under Idaho Code § 12-120. Harnes defended the civil action until the trial court stayed the litigation and ordered arbitration. The trial court

rejected Harnes application for attorney fees incurred in the arbitration, and incurred by Harnes in the civil action before and after the referral to arbitration, concluding that the only "claim" on which Harnes prevailed in the civil action was the motion to compel arbitration.

This doesn't make sense. The Idaho cases teach that applications to confirm arbitration awards standing alone are not civil actions that support applications for attorney fees under either Section 41-1839 or Section 12-120. How then, can the "claim" contained in a motion to compel arbitration be a civil action supporting the trial court's limited award of attorney fees in this case. Harnes appreciates the trial court's decision to make the limited award of attorney fees for the effort incurred in compelling arbitration, but that was not the gravamen of the civil action. The gravamen of the civil action was the breach of the purchase and sale agreement.

If Harnes had been unsuccessful in their motion to compel arbitration and the matter had proceeded to trial against Harnes and Baker Commodities, there would be no doubt that the prevailing party in that action would have been entitled to attorney fees under Idaho Code § 12-120(3). Why then, once the litigation is stayed and the matter involving one of two defendants is referred to arbitration, should there be a different result?

Until very recently, this Court had not decided a case where there is a suit over a commercial transaction and during the course of the suit the matter is referred to arbitration.[1]

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[1] Harnes recognize that dicta in *Barbee v. WMA Securities, Inc.*, 143 Idaho 391, 146 P.3d 657, 662 (2006) and *Deelstra v. Hagler*, 145 Idaho 922, _____, 188 P.3d 864, 867 say that filing a civil action before arbitration still does not permit the trial court to award attorney fees

The parties and the trial court did not have the benefit of this Court's decision in *Deelstra v. Hagler*, 145 Idaho 922, 188 P.3d 864 (2008) at the time of Harnes' application for attorney fees and costs. *Deelstra* answers the first question on appeal: whether Harnes are entitled to their attorney fees before and after referral of the civil action on a commercial transaction to arbitration. They are, and the trial court's decision denying most of Harnes attorney fees before the matter was referred to arbitration and Harnes' attorney fees after the matter was returned from arbitration should be reversed and the matter remanded for reconsideration of the attorney fee application in light of *Deelstra*.

As tantalizing close as *Deelstra* came, it did not decide the question in this case: is the prevailing party in a civil action over a commercial transaction entitled to attorney fees under Idaho Code § 12-120(3), where during the course of the civil action the matter is referred to arbitration, the arbitrator has the arbitration agreement, the arbitration agreement is silent on the issue of attorney fees, and the arbitrator does not presume to decide the question of attorney fees.

Harnes concedes that *Deelstra* decided that the trial court improperly modified the award of the arbitrator to deny the prevailing party attorney fees incurred in arbitration. Even though the parties both asked the arbitrator to award attorney fees to the prevailing party, no written arbitration agreement was ever presented to the arbitrator.

Here there was no award by the arbitrator on attorney fees, so there was nothing for

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incurred in arbitration under Idaho Code §§ 30-1446 and 12-120(3).

the trial court improperly to modify.

Deelstra also did not reach the apparently dichotomy between this Court's treatment of attorney fees incurred in arbitration involving suits between insureds and insurers and this court's treatment of attorney fees incurred in arbitrations involving commercial transactions. The two statutes, Section 41-1839 and Section 12-120, are in pari materia and should be treated the same. Neither is a penalty. Each is intended to be an additional sum to represent just compensation. Each is a substantive right. Only Section 41-1839 is a one-way street, while Section 12-120 is facially neutral. This Court has decided that Section 41-1839 is an implied term in an insurance policy; so far this Court has not made the same decision for Section 12-120. These distinctions are, however, without a difference. Calling Section 41-1839 an implied term in an insurance policy is just a fiction to circumvent the restrictions in the Idaho Arbitration Act, the American Arbitration Association rules, and presumably language in insurance policies requiring the parties to bear their own attorney fees. There is no reason that the same fiction should not be indulged in commercial transactions. Those who enter into commercial transactions in Idaho are held to knowledge of the substantive law, which shifts fees to the prevailing party. The public policies furthered by indulging such a fiction are identical.

Yet, insureds are entitled to an award of attorney fees in a civil action to recover the amount justly due under a policy of insurance including the attorney fees incurred in arbitration, while the prevailing party in a commercial transaction is denied the same right.

Unless there is a special place in Hell for insurance companies, which would make Section 41-1839 a penalty, there is no reason to treat these two statutes differently. This case squarely puts the proposition that either both insureds and prevailing parties in suits over commercial transactions should get their attorney fees when they prevail or neither should.

5. Harnes are entitled to their attorney fees on appeal. This appeal fortuitously anticipated the decision in *Deelstra* that Harnes are entitled to their attorney fees in this suit involving a commercial transaction, at least for the time before and after the referral to arbitration. Harnes also submit that they are entitled to their attorney fees incurred in arbitration for the reasons stated above. In order to vindicate the Harnes' statutory right to have the responsibility for attorney fees shifted to the non-prevailing party in a civil action over a commercial transaction under Idaho Code § 12-120(3), Harnes are entitled to their attorney fees on appeal.

IV. CONCLUSION

Harnes are entitled to their attorney fees incurred before and after the referral to arbitration in this civil action over a commercial transaction. Harnes are entitled to their attorney fees incurred in arbitration, because there is no reason for discriminating against prevailing parties in commercial transactions. Harnes are entitled to their attorney fees on appeal. Therefore Harnes request that this Court reverse the decision of the trial court, and remand the matter for consideration of Harnes attorney fee claim in light of *Deelstra* and in light of a decision entitling Harnes to their attorney fees incurred in arbitration.

RESPECTFULLY SUBMITTED this 8 day of September, 2008.

RAMSDEN & LYONS, LLP

By _____
Michael E. Ramsden, Of the Firm
Defendants/Appellants

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 8 day of September, 2008, I served a true and correct copy of the foregoing by the method indicated below, and addressed to the following:

Michael B. Hague
Paine Hamblen LLP
PO Box E
Coeur d'Alene, ID 83816-0328

✓ US Mail
____ Overnight Mail
____ Hand Delivered
____ Facsimile (208) 666-0550

_____
Michael E. Ramsden