

**IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON**

PETERSON POWER SYSTEMS, INC., )	
a California corporation, )	DIVISION ONE
)	
Respondent, )	
)	No. 59337-4-I
vs. )	(Consolidated with
)	No. 59839-2-I)
TURNER LOGISTICS, LLC, a )	
Washington corporation and a division )	UNPUBLISHED OPINION
of TURNER CONSTRUCTION )	
COMPANY, a Washington corporation, )	FILED: November 5, 2007
)	
Appellant. )	
_____ )	

Baker, J. — Turner Logistics, LLC (Turner) appeals a summary judgment in favor of Peterson Power Systems, Inc. (Peterson) which seeks reimbursement from Turner of funds Peterson repaid to a third party as part of a bankruptcy settlement. We affirm in part and reverse in part.

I

Exodus Communications (Exodus), an internet data and web hosting company, planned to build a data center in Virginia. The project was to consist of two buildings, referred to simply as Building One and Building Two. Turner was a subcontractor

retained to install emergency generators for the buildings. Turner contracted with Peterson to supply the generators.

Before the project was completed, Exodus cancelled Building Two. Exodus settled directly with Peterson for damages arising from the cancellation, by paying Peterson \$1,766,852.

Shortly after paying Peterson, Exodus filed for bankruptcy protection. Subsequently, the bankruptcy trustee filed a complaint against Peterson seeking return of the sum paid to Peterson, on the grounds that the payment Peterson received from Exodus constituted a voidable preference under section 547 of the Bankruptcy Code.<sup>1</sup>

In the meantime, Turner and Peterson signed a settlement agreement. The agreement dealt principally with a claim involving Building One, but also addressed the issue of Exodus's payment to Peterson. Recital 6 of the agreement reads:

Peterson Power has notified Turner Logistics that in the event the payment by Exodus to it is determined to be a voidable preference and Peterson Power has to pay the money back to Exodus or to its creditors in the bankruptcy proceeding, Peterson Power will make claim for the same amount against Turner Logistics. Turner Logistics denies that it would have any obligation to Peterson Power to repay it any such amount or portion thereof.

The agreement further stipulates that:

Peterson Power reserves any rights it may have to assert a claim against Turner Logistics arising from the cancelled order in the event the referenced payment by Exodus to Peterson Power is set aside as a preference. Turner Logistics reserves all rights to dispute any further obligations to Peterson Power.

Essentially, while resolving the comparatively minor issue related to Building

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<sup>1</sup> 11 U.S.C.A. § 547.

One, the parties agreed to disagree about the potential consequences of the trustee's bankruptcy claim against Peterson.

Almost two years later, Peterson signed a settlement agreement with Exodus (now EXDS, the reorganized debtor entity under the bankruptcy plan). In that agreement, Exodus contended that the payments to Peterson constituted a voidable preference under section 547 of the Bankruptcy Code. Peterson, in turn, denied that the payment was voidable. Nevertheless, it was the stated desire of both parties to settle fully and finally all disputes between them. Accordingly, Peterson agreed to pay \$830,000 to Exodus in exchange for dismissal of the complaint. Peterson then looked to Turner for compensation under the terms of their settlement agreement. Turner declined to pay, and Peterson filed this suit.

The trial court dismissed all of Turner's affirmative defenses, denied Turner's cross-motion for summary judgment, and granted Peterson summary judgment. The court subsequently awarded Peterson \$830,000 plus interest, attorney fees, and costs.

Turner now appeals.

## II

We review orders granting summary judgment de novo, engaging in the same inquiry as the trial court.<sup>2</sup> We view the facts and all reasonable inferences in the light most favorable to the nonmoving party.<sup>3</sup> Summary judgment is appropriate if reasonable persons could reach only one conclusion.<sup>4</sup> Summary judgment is proper if

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<sup>2</sup> Wm. Dickson Co. v. Pierce County, 128 Wn. App. 488, 492, 116 P.3d 409 (2005).

<sup>3</sup> Vallandigham v. Clover Park Sch. Dist. No. 400, 154 Wn.2d 16, 26, 109 P.3d 805 (2005).

a written contract, viewed in light of the parties' objective manifestations, has only one reasonable meaning.<sup>5</sup>

### Contract Interpretation

Washington follows the objective manifestation theory of contracts, whereby we interpret what was written, not what was intended to be written.<sup>6</sup> Surrounding circumstances and other extrinsic evidence may be used to determine the meaning of specific words and terms used, but not to show an intention independent of the instrument, or to vary, contradict, or modify the written words.<sup>7</sup>

Under this approach, we attempt to determine the parties' intent by focusing on the objective manifestations of the agreement, rather than on the unexpressed subjective intent of the parties, imputing an intention corresponding to the reasonable meaning of the words used.<sup>8</sup>

The settlement agreement between Turner and Peterson states that, in the event the payment Peterson received from Exodus "is determined to be a voidable preference and Peterson Power has to pay the money back to Exodus . . . in the bankruptcy proceeding, Peterson Power will make claim for the same amount against Turner Logistics." Peterson further reserved the right to assert a claim against Turner in the event the payment by Exodus to Peterson "is set aside as a preference." Turner

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<sup>4</sup> Dickson, 128 Wn. App. at 492.

<sup>5</sup> Go2Net, Inc. v. C I Host, Inc., 115 Wn. App. 73, 83, 60 P.3d 1245 (2003).

<sup>6</sup> Hearst Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 503-04, 115 P.3d 262 (2005).

<sup>7</sup> Hearst, 154 Wn.2d at 503 (quoting Hollis v. Garwall, Inc., 137 Wn.2d 683, 695-96, 974 P.2d 836 (1999)).

<sup>8</sup> Hearst, 154 Wn.2d at 503.

reserved the right to dispute any further obligations to Peterson.

An avoidable preference is defined as a transfer of an interest of the debtor in property (1) to or for the benefit of a creditor, (2) on account of an antecedent debt, (3) made while the debtor was insolvent, (4) made on or within 90 days before the date of the filing of the petition, and (5) that enables the creditor to receive more than the creditor would receive if the transfer had not been made and the creditor received payment under a chapter 7 liquidation.<sup>9</sup>

A proceeding to avoid a preference is an adversary proceeding and must be brought by summons and complaint.<sup>10</sup> A trustee seeking to recover payments has the burden of proving by a preponderance of the evidence that a preferential transfer occurred.<sup>11</sup>

The settlement agreement between Turner and Peterson reserves Peterson's right to pursue a claim if Exodus's payment "is determined to be a voidable preference," or is "set aside as a preference." Turner and Peterson disagree about the meaning of these phrases.

Peterson argues that review of the circumstances surrounding the making of the settlement agreement confirms that the parties understood the phrase "set aside as a preference" to mean repayment by Peterson of any funds received from Exodus as a result of the bankruptcy proceeding. Turner argues that a contextual analysis is inappropriate, and that the meaning of the terms may be gleaned from the plain

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<sup>9</sup> 11 U.S.C.A. § 547(b) (2000).

<sup>10</sup> In re Dyson, 348 B.R. 314, 317 (Bankr. E.D. Va. 2006).

<sup>11</sup> See 11 U.S.C.A. § 547(g); In re Merritt, 7 B.R. 876 (Bankr. W.D. Mo. 1980).

language of the agreement.

Peterson argues that its settlement with Exodus satisfied the requirements of its agreement with Turner. In its demand letter to Turner following the settlement with Exodus, Peterson stated that the “final resolution” of the bankruptcy claim had the effect of liquidating the obligation of Turner to reimburse Peterson.

Turner argues that Peterson is barred from seeking recovery from Turner because no judicial determination was made that Exodus’s payment was in fact a voidable preference. The settlement agreement between Peterson and Exodus does not stipulate that it is a preference repayment.

The plain language of the settlement agreement does not require a formal judicial determination that a preference occurred. Its terms do not oblige Peterson to commit itself to the rigors of a full trial rather than enter into a settlement with Exodus. The settlement agreement between Peterson and Exodus was reached in response to Exodus’s lawsuit. The bankruptcy trustee’s complaint raised a single issue, namely whether Exodus’s payment to Peterson should be set aside as a preference under section 547 of the Bankruptcy Code. In the agreement, the parties expressed their desire and intention to settle the dispute. Under the agreement, Peterson agreed to pay \$830,000 and the trustee agreed to dismiss the complaint. The bankruptcy court accepted the settlement when it dismissed the lawsuit.

We decline to read into the agreement a requirement that Peterson’s right to seek repayment from Turner be contingent on a bankruptcy court determining, after a full trial, that Exodus’s payment was a voidable preference, and setting it aside. The

only reasonable interpretation of Peterson's payment to Exodus is that it was a negotiated repayment of a portion of an alleged voidable preference, which triggered its right to seek reimbursement from Turner.

While Turner urges us to confine our analysis to the four corners of the contract in interpreting the meaning of "set aside," and "determine," it invites us to consider extrinsic evidence to find a mutual promise to cooperate.

Turner argues that one of the purposes of the agreement between itself and Peterson was to "cooperate" against Exodus's preference claim, and Peterson was thus not free to repay part of the amount received from Exodus without Turner's involvement. Evidence for such a promise in the record is meager. The agreement itself contains no promise to cooperate, and we will not write one into existence.

### Novation

Turner argues in the alternative that Exodus's payment to Peterson constituted a novation, relieving Turner of any further obligation to Peterson.

Novation has been described as a mutual agreement among all parties concerned for discharge of a valid existing obligation by the substitution of a new, valid obligation on the part of the debtor or another.<sup>12</sup> To effect a novation there must be a clear and definite intention on the part of all concerned that novation is the purpose of the agreement, for it is a well settled principle that novation is never to be presumed.<sup>13</sup> A novation may be effected by three parties; an existing obligation is discharged when

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<sup>12</sup> Dere v. Montgomery Ward & Co., Inc., 295 S.E.2d 794, 795 (Va. 1982) (quoting Honeywell v. Elliott, 189 S.E.2d 331, 334 (1972)). Because Turner's novation defense arises from the original contract, Virginia law governs our review.

<sup>13</sup> Dere, 295 S.E.2d at 795 (quoting Honeywell, 189 S.E.2d at 334).

a creditor, his debtor, and a third person agree to substitute a new obligation running from the third person to the creditor.<sup>14</sup> The party claiming a novation bears the burden of proving every essential element of the claim.<sup>15</sup> To find novation, a court requires “clear and satisfactory” proof of “a clear and definite intention on the part of all concerned.”<sup>16</sup>

It is apparent from the record that Turner understood it was liable to Peterson for the Building Two charges, at least until Exodus made payment to Peterson. What is not to be found in the record is “clear and satisfactory” proof of “a clear and definite intention” by Peterson to relieve Turner of ultimate liability based upon Exodus’s payment of the cancellation fee. Indeed, the record shows Peterson expressly declined to release Turner from its liability.

Novation is a contract consisting of two stipulations, one to extinguish an existing obligation, the other to substitute a new one in its place.<sup>17</sup> While it is undisputed that Exodus paid Peterson, the record lacks any stipulation that Turner’s obligation was thus unconditionally extinguished, and a new obligation substituted in its place. A novation will not be implied from the mere performance of the contract by a substitute even though the party having notice of the assignment assents thereto and enters into the performance of the contract with the new party.<sup>18</sup> No delegation of performance relieves the delegating party of any duty to perform or any liability for

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<sup>14</sup> Dere, 295 S.E.2d at 795.

<sup>15</sup> Dere, 295 S.E.2d at 796.

<sup>16</sup> Dere, 295 S.E.2d at 796 (quoting Honeywell, 189 S.E.2d at 334).

<sup>17</sup> Michie’s Jurisprudence of Virginia & West Virginia § 3 (2007).

<sup>18</sup> Michie’s Jurisprudence of Virginia & West Virginia § 3.

breach.<sup>19</sup> There is no clear and satisfactory evidence of a novation.

Even if there had been a novation, the novation would have been extinguished by Exodus's subsequent bankruptcy. The Restatement (Third) of Suretyship and Guaranty explains that under certain circumstances, a discharged duty may be revived by bankruptcy.

When a secondary obligation is discharged in whole or part by performance by the principal obligor or another secondary obligor, or by realization upon collateral securing such performance, the secondary obligation revives to the extent that the obligee, under a legal duty to do so, later surrenders that performance or collateral, or the value thereof, as a preference or otherwise.<sup>[20]</sup>

Turner looks to the Restatement, section 70, comment c., and argues that Peterson's repayment to Exodus was voluntary, and that Turner's obligation was consequently not revived by Exodus's bankruptcy. Comment c. states that the rule is

not applicable to voluntary return of payment. If the obligee returns performance received from the principal obligor when not required to do so by law, the rule in this section does not apply.<sup>[21]</sup>

Turner notes correctly that the principle laid out in comment c. is based on the Virginia Supreme Court case Horner v. First National Bank of St. Mary's of Leonardtown, Maryland.<sup>22</sup> Turner cites the Horner court's discussion of legal duty and restitution.

In the event that the payee was forced to make restitution, they [the indorsers] would be exactly where they were before and would have to do no more than they had originally contracted to do, which was to pay the note if the maker did not.<sup>[23]</sup>

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<sup>19</sup> Va. Code Ann. § 8.2-210(1).

<sup>20</sup> Restatement (Third) of Suretyship and Guaranty § 70 (1996).

<sup>21</sup> Restatement (Third) of Suretyship and Guaranty § 70, cmt. c. (emphasis added).

<sup>22</sup> 141 S.E. 767 (1928).

According to Turner, because Peterson was not required by law to repay Exodus, as specified in the Restatement, and was not forced to make restitution, as discussed by the Horner court, the Exodus bankruptcy did not revive Turner's liability.

But this argument misconstrues the nature of voluntariness. Peterson did not spontaneously return the money to Exodus. It responded to a lawsuit, and entered lengthy negotiations with Exodus before ultimately reaching a settlement. We do not regard the settlement as uncoerced. A lawsuit necessarily implies a degree of compulsion. A payment made in settlement of contested litigation is not truly voluntary.

Peterson's repayment to Exodus was not voluntary; it was forced to make partial restitution to Exodus, thus placing Turner where it was before. Turner has to do no more than it originally agreed to do, namely pay Peterson to the extent that Exodus did not.

We hold that there was no novation.

### Damages

Turner asserts that any recovery Peterson might receive is limited to actual costs incurred in manufacturing the generators and equipment for Building Two. It cites to the termination clause in the contract:

TERMINATION: Buyer shall have the right to terminate this . . . Project Work Order, in whole or in part, at any time and without cause . . . Buyer shall pay Seller all actual costs of manufacturing all conforming finished goods . . . .

Turner did not object to the amount Exodus paid to Peterson as its recoverable

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<sup>23</sup> Horner, 141 S.E. at 770 (emphasis added).

costs due to the contract cancellation. Indeed, it informed Peterson that in the event Exodus did not pay Peterson as agreed, Turner would honor its contractual obligations. Exodus agreed to pay Peterson directly, and Turner accepted that Exodus would do so. A principal is bound by its agent's agreement if the principal ratifies the agreement by accepting its benefits with full knowledge of the relevant facts, or if upon learning of the agreement, he fails promptly to disavow it.<sup>24</sup>

Peterson is not required to prove its actual costs, but may recover from Turner the lesser amount it repaid to Exodus.

### Attorney Fees

Turner asks that we reverse the trial court's award of attorney fees and costs. Whether a party is entitled to attorney fees is an issue of law which is reviewed de novo.<sup>25</sup> Generally, Washington courts will not award attorney fees as part of litigation costs absent a contractual, statutory, or equitable ground.<sup>26</sup> For purposes of a contractual attorney fee provision, an action is on a contract if the action arose out of the contract and if the contract is central to the dispute.<sup>27</sup>

In the present case, there are two contracts; the original project work order and the settlement agreement. Only the settlement agreement contains an attorney fee provision. It reads:

In the event of litigation between the parties, declaratory or otherwise, in connection or arising out of this Agreement, the substantially prevailing

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<sup>24</sup> Kilby v. Pickurel, 396 S.E.2d 666, 668 (Va. 1990).

<sup>25</sup> Taliesen Corp. v. Razore Land Co., 135 Wn. App. 106, 141, 144 P.3d 1185 (2006).

<sup>26</sup> Tradewell Group, Inc. v. Mavis, 71 Wn. App. 120, 126, 857 P.2d 1053 (1993).

<sup>27</sup> Seattle-First Nat'l Bank v. Wash. Ins. Guar. Ass'n, 116 Wn.2d 398, 413, 804 P.2d 1263 (1991).

party shall recover its costs, including experts' fees, and attorneys' fees actually incurred, including for appeals.

Peterson's complaint against Turner alleged breach of contract and unjust enrichment. In both the complaint and its motions for summary judgment, Peterson sought recovery of the cancellation fee under the original project work order. In its first motion, Peterson described the settlement agreement as being "unrelated to the outstanding cancellation fee." While it addressed the settlement agreement in refuting Turner's affirmative defenses, Peterson based its claim against Turner on the terms of the original contract. In its second motion for summary judgment, Peterson asked the court to find that the project work order obligated Turner to pay the cancellation fee. Peterson asserted that the clear language of the contract established Turner's obligation to pay the cancellation fee. In contrast, Peterson relied upon the terms of the settlement agreement in requesting attorney fees and costs.

For its part, Turner relied on the language of the settlement agreement to argue that Peterson's repayment to Exodus had not been determined to be a voidable preference.

The settlement agreement resolved a dispute relating to the construction of Building One. Additionally, it reserved both Peterson's right to assert its claim against Turner regarding the cancellation fee, and Turner's right to dispute such a claim. The settlement agreement did not resolve the dispute over the bankruptcy preference; it served, rather, as a place holder. Unlike the issues related to Building One, which were resolved, the settlement agreement kept the dispute over Building Two alive. Had a subsequent dispute arisen between the parties over issues related to

Building One, the settlement agreement would provide that the prevailing party be awarded attorney fees and costs. The dispute in question, however, arose out of Building Two; it arose, not out of the settlement agreement, but out of the original contract.

Both parties cite to CPL, L.L.C., v. Conley<sup>28</sup> to support their arguments. CPL entered into a purchase agreement to buy nursing facilities. The purchase agreement contained an attorney fees provision. One year after entering into the agreement, CPL and the seller signed a memorandum agreement under which the seller agreed to make an earnout payment of a specific amount. Subsequently CPL sued the seller, claiming it had overpaid and seeking a refund. The trial court granted the seller summary judgment, but denied its request for attorney fees.<sup>29</sup> On appeal, the court upheld the trial court's decision not to award fees.<sup>30</sup> It noted that while the initial purchase agreement contained an attorney fees provision, the subsequent memorandum did not.<sup>31</sup> It concluded that the action was not "instituted to enforce or interpret" a term of the purchase agreements.<sup>32</sup> Rather, the purpose of the action was to void the subsequent and separate memorandum agreement that determined the specific earnout payment figure.<sup>33</sup>

Here, the original contract contains no attorney fees provision. The settlement

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<sup>28</sup> 110 Wn. App. 786, 40 P.3d 679. (2002).

<sup>29</sup> CPL, 110 Wn. App. at 790.

<sup>30</sup> CPL, 110 Wn. App. at 797.

<sup>31</sup> CPL, 110 Wn. App. at 797.

<sup>32</sup> CPL, 110 Wn. App. at 797.

<sup>33</sup> CPL, 110 Wn. App. at 798.

agreement, unlike the memorandum agreement in CPL, did not resolve the dispute between the parties, or bind them to any affirmative acts. As noted above, in matters pertaining to Building Two, the parties agreed to disagree. Peterson's claims arose out of the original project work order. Indeed, the language of the settlement agreement states as much:

Peterson Power reserves any rights it may have to assert a claim against Turner Logistics arising from the cancelled order in the event the referenced payment by Exodus to Peterson Power is set aside as a preference. Turner Logistics reserves all rights to dispute any further obligations to Peterson Power. (Emphasis added.)

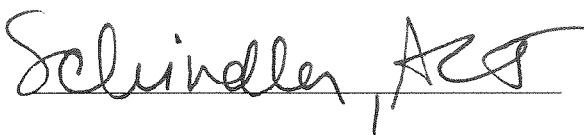
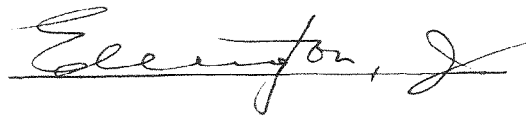
The subsequent settlement agreement imposed no affirmative duty on either party regarding the Building Two dispute. In it, Turner explicitly disavowed any further obligation to Peterson. The agreement merely reserved each party's rights in the event the Exodus payment was set aside as a preference. Thus, it cannot be said that the current litigation is in connection with or arising out of the settlement agreement. It arose out of the original contract, which contained no attorney fee provision.

We reverse the award of attorney fees to Peterson.

AFFIRMED IN PART/REVERSED IN PART.

  
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WE CONCUR:

   
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