No. 733478

IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON
DIVISION I

Key Development Pension, Appellant

v.

Clyde E. Carlson and Priscilla A. Carlson, Respondents

BRIEF OF APPELLANTS

Stephan E. Todd, WSBA # 12429
14319 15th Drive SE
Mill Creek, WA 98012
(425) 585-0274
Attorney for Key Development
Pension, Appellant

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2. The trial court erred in entering Finding of Fact No. 6 with respect to using the proceeds of the April 2002 loan to pay a variety of personal expenses.

3. The trial court erred in entering Finding of Fact No. 8 by finding that the memories of Mr. Johnson and Mr. Dahlby are "lacking".

4. The trial court erred in entering Finding of Fact No. 9 by finding that tax returns and information was too far afield and not helpful in determining the purpose of the loan and "there may have been some loaning of funds back and forth the between the corporation and the shareholder, Mr. Carlson."

5. The trial court erred in entering Finding of Fact No. 10.

6. The trial court erred in entering Finding of Fact No. 12 by finding that "Mr. Carlson used a material portion of the $150,000 (of the April 2002) loan to pay a settlement of a personal legal matter involving his sister."

7. The trial court erred in entering Finding of Fact No. 13 in that the loans appeared to be personal loans.

8. The trial court erred in admitting Exhibits 60, 61, 63, 64, 66, 67, and 68, and entering Finding of Fact Nos. 14 and 15 based on those exhibits.

9. The trial court erred in entering Finding of Fact No.19.

10 The trial court erred in concluding as a matter of law that Key did not meet its burden of proof that the loans were exempt under RCW 19.52.080.

11. The trial court erred in entering judgment against Key on Carlsons' usury defense.

II. ISSUES PERTAINING TO ASSIGNMENT OF ERRORS

1. Did Key meets its burden of establishing the loans to Carlson were business loans? (Assignment of Errors 1-11).

2. Can a borrower who is not by adversity and necessity driven to borrow money at any cost raise usury as a defense? (Assignment of Errors 10 and 11).

III. STATEMENT OF FACTS

This is an appeal from a judgment against Key Development Pension for violation of Washington's usury statute, RCW 19.52.020. This matter was initiated by Key for the collection of two promissory notes, one dated November 10, 2000 ("Note 1") (EX 1) and one dated April 18, 2002 ("Note 2") (EX 13) executed by the defendants Clyde and Priscilla

Carlson ("Carlson") and each in the amount of $150.000.00. The lender on Note 1 was G & G Meats Pension fund ("G & G"). The Payee on Note 2 was Columbia Meats Product Pension Fund ("Columbia"), the successor of G & G. Both notes are now held by the Appellant Key Pension ("Key"). Jack Johnson ("Johnson") is a trustee of Key. CP 172, FF 1.

Carlson made interest only payments every year beginning in 2001 with the last interest payments made in the fall of 2010. EX 2-12; EX 14-23. No payments were ever made towards the principal of either note. Each and every payment on both notes was made on a check drawn on either the business accounts of Northwest Seaplanes, Inc. or San Juan Air, a trade name used by Northwest.[1] When Key sued in 2012 to collect the principal amount of the notes together with accrued interest, Carlson claimed for the first time that the loans were for personal use and the interest rate charged was in violation of Washington's usury statute, RCW 19.52.020. CP 1-5.

Note 1 provided that interest only payments would be made in four increments beginning in July 2001. EX 1. Subsequent payments were to be made in August, September and October of 2001. Those dates coincided with Northwest's busiest season when Northwest's income from

[1] Clyde Carlson testified at trial that he had no ownership interest in San Juan Airlines when checks were written to pay the loan from Key. RPI 48.

its operations were highest. CP 179, FF 19. This payment schedule was requested by Clyde Carlson. RPI 27.[2] Under its express terms, Note 1 matured in November 2001, with Carlson having the option to extend the term for an additional one year period. Note 1 was not paid in full in November 2001 or 2002 and Carlson continued to pay interest only on Note 1 until 2010. CP 173, FF 6.

Note 2 did not provide for periodic payments but provided that all principle and accrued interest would be paid in full one year from the date of the note. EX 13. However, Carlson made, and Key accepted, payments under the same schedule set out in Note 1: an interest payment in July, August, September and October. Note 2 was not paid in full in one year and Carlson continued to make interest only payments on both Note 1 and Note 2 until 2010. CP 173, FF 6.

From the first payment in July 2001 on Note 1 through the last payments in 2010 on both notes, all payments were made with checks drawn on Carlson's company, Northwest Seaplanes, Inc. or San Juan Airlines, a business name of Northwest Seaplanes, Inc. EX 2-13; EX 14-23. Some of the checks even had an accounting code indicating that the

[2] The trial commenced on October 13, 2014. On October 14, 2014, the parties entered into an all day mediation before the Honorable Susan K. Cook. Due to scheduling issues, the trial did not reconvene until October 20, 2014. The Report of Proceedings for each of the two days of trial commences with page number 1 so the reference to the Report of Proceedings for the trial on October 13, 2014 will be referred to as RPI and the Report of Proceedings for the final day of trial on October 20, 2014 will be referred to as RPII.

company's payment was for a "long term liability". See for example EX 9. RPI 50.

Carlson did not represent to Key that he was going to use the loan proceeds for a personal use. RPI 26. Indeed, Clyde Carlson testified that he did not recall any conversation with either Mr. Johnson or Mr. Carlson about his intentions. CP 174, FF 8.

In 2001, after all payments on Note 1 had been made by checks drawn on the checking account of Carlson's business, Northwest Seaplanes, Inc., and after borrowing an additional $200,000.00 in 2001 from Gary Dahlby, Carlson asked for another loan in 2002 in the amount of $150,000.00 and Key was again told the new loan was an additional business loan with the proceeds to be used for business purposes. RPI 124.

Jack Johnson and Gary Dahlby[3], both long-time friends with Mr. Carlson, testified at trial that Mr. Carlson told them that both the original loan in 2000 and the second loan in 2002 were for business purposes. RPI 101; RPI 124. In his pre-trial deposition Mr. Carlson was asked the following question and gave the following answer:

> Q. Now when you borrowed this money, what did you tell Mr. Johnson or Mr. Dalby (sic) what you were going to use the money for?

[3] Both Mr. Johnson and Mr. Dahlby were trustees of the pension fund when the loans in 2000 and 2002 were made. CP 173, FF 1.

A. I don't recall having a discussion about what it was being used for.

Deposition of Clyde Carlson, page 35; RPI 23. Mr. Carlson also stated in his deposition that he did not not even know why he borrowed the money from the pension fund.

Q. How did it come about that you borrowed money from G & G Meats Pension Fund.

A. You know, I don't recall that, why.

Deposition of Clyde Carlson, pages 31-32; RPI 22.

Mrs. Carlson, who spent over a decade in the banking industry, had no involvement in the loan negotiations and did not know about the loans until she was asked by her husband to sign the loan documents. She also testified in her deposition in October 2013 that she didn't even know even then what the purpose of the loans was.

Q. Do you know where the money or the loan proceeds went?

A. No.

. . .

Q. Do you know what the money was used for.

A. No, I don't.

Deposition of Priscilla Carlson, page 14, RP 24.

In 2000 and 2002, when these loans were made, Carlson owned his primary residence in Seattle (RPI 76), a vacation home in Chelan, Washington with two adjacent unimproved lots (RPI 76), a vacation home in Arizona (RPI 76), several airplanes (RPI 71-72), and an airplane hangar in Chelan, Washington. (RPI 72). Carlson also owned another unimproved lot in Arizona which they sold in 2000. RPI 70. Carlson testified that the loan proceeds from the 2000 loan were used to buy a vacation apartment in Campbell River, British Columbia, Canada for $105,000.00 Canadian and to remodel the vacations homes in Arizona and in Chelan Washington. RPI 76; RPII 49. At the same time as the purchase of the vacation apartment in Campbell River, Clyde Carlson, or his company, purchased a fuel dock and maintenance facility in Campbell River. RPI 77. The fuel dock, repair facility and the apartment were all sold at the same time some time later. The fuel dock, maintenance facility and apartment were all located together. RPI 78. In 2000, Clyde Carlson, the sole-shareholder of Northwest Seaplanes, Inc., loaned over $87,000 to his company. EX 75. In 2001, Carlson also made an additional loan to Northwest Seaplanes, Inc. and at the end of 2001 Northwest Seaplanes, Inc. reported nearly $250,000.00 in outstanding loans from Mr. Carlson. EX 75.

Between the first and second loans from Key, Carlson borrowed $200,000.00 directly from Mr. Dahlby. Carlson signed a one year note with an interest rate at 14%. EX 80 (11/19/01 Promissory Note). That loan was treated by Carlson the same way as the loans from Key. EX 80 (Clyde Carlson Payment History). The loan interest was paid at the same time the interest payments on Note 1 and Note 2 were paid (RPI 92) and were paid with checks drawn on the business account of either Northwest Seaplanes, Inc. or San Juan Air. EX 80; RPI 93. That loan was repaid in 2004 and Carlson admitted that that loan was for a business purpose.[4] EX 80; RPI 91.

During the entire time the two loans to Carlson were outstanding, from 2001 through 2013, Key listed the loans on their annual reports as loans to Northwest Seaplanes. EX 74.

IV. ARGUMENT

A. **The determination of whether a loan violates Washington's usury stattue is an issue of law reviewed *de novo* by this Court.**

[4] The trial judge dismissed the importance of the information in the Carlsons' personal tax returns and on the corporate tax returns of Northwest Seaplanes, Inc. noting that none of the returns showed deductions for the interest payments made by Northwest on the loans from Key Pension.. However, neither Carlson nor Northwest deducted any interest payments on the loan from Gary Dahlby although that loan was admittedly a business loan. It is important to note that although the corporate tax returns and the personal returns did not deduct the interest paid on the two loans, none of the tax returns showed that the payments made by Northwest on what Carlson claims was a personal obligation were treated as income to Carlson, corporate dividends or repayment of loans from shareholders. The money paid to Key and Dahlby by Northwest Seaplanes, Inc. was simply ignored by the corporation and Carlson.

The ultimate determination of the primary purpose of a loan as it relates to the usury statute is not an issue of fact, it is an issue of law. Jansen v. Nu-West, Inc., 102 Wn.App. 423, 434-435, 6 P.3d 98 (2000); *see also,* Brown v. Giger, 111 Wn.2d 76, 757 P.2d 523 (1998). Issues of law are reviewed *de novo.* Cosmopolitan Eng'g Group, Inc. v. Ondeo Degremont, Inc., 159 Wash.2d 292, 298, 149 P.3d 666 (2006) (" Statutory interpretation is a question of law, subject to de novo review.").

B. **Key met its burden of proving the applicability of the business purpose exemption to usury.**

1. Key offered uncontroverted evidence that Carlson represented the loans were for a business purpose.

The only evidence offered at trial on the purpose of the loan to Carlson from the pension fund was from the testimony of Mr. Johnson and Mr. Dahlby. Both testified that for the first loan in 2000, Mr. Carlson represented that he needed the money for his seaplane business, Northwest Seaplanes, Inc. RPI 101 ; RPI 124 . After making payments on that loan in 2001 and 2002 from the business banking account of Northwest, Carlson again approached Mr. Johnson in 2002 and asked for an additional loan for his business. RPI 124. The testimony of Mr. Johnson and Mr. Dahlby was not controverted by any testimony from Carlson or anyone else. Priscilla Carlson did not even know that they were borrowing

money until she signed the promissory notes and still does not know why the money was borrowed or for what purpose it was used. RPII 45.

The trial judge chose not to accept the uncontroverted testimony of Mr. Johnson and Mr. Dahlby, not because he didn't believe them or that he questioned their credibility, but because he found that their 15 year old memories were "lacking". CP 174, FF 8. This observation is evidently based on their inability to know every detail of these loans or other loans made by Key. However, none of the other loans made by Key were in default or had borrowers who claimed the loans violated the usury statute, or were even relevant to the loans in question in this matter. If a witnesses' testimony can be dismissed because that witness cannot remember every minute detail about events that have nothing to do with the matter at issue then no eye witness testimony would carry any weight. No one's memory is perfect. Both Mr. Dahlby and Mr. Johnson were clear in their testimony of what was represented to them about why Carlson wanted the money. Evidently the trial court believed Clyde Carlson that the purpose of the loan was not even discussed. which given the amount of the loan, is hard to believe.

2. The trial court relied on inadmissible evidence to conclude that the loans were personal loans.

The trial court admitted Exhibits 58, 59, 60, 61, 63, 64, 65, 66, 67 and 68 all later loans by Key which had documentation regarding the business purpose of those loans. Key objected to the admission of these exhibits on grounds of relevancy. RPI 164, RPI 172, RPI 167, RPI 168, RPI 160, RPI 161, RPI 131, and RPI 139. These loans were made after the loans to Carlson and were not made to someone who Johnson and Dahlby had known for several decades. RPII 38. Based on these other later loans, the trial court found that Key knew in 2000 and 2002 how to document business loans and therefore the loans to Carlson must be personal loans. CP 175-176, FF 14, FF 15 AND FF 16.

ER 401 through 412 are evidence rules dealing with the relevance of evidence and its admissibility. ER 406 provides:

> Evidence of the habit of a person or of the routine practice of an organization, whether corroborated or not and regardless of the presence of eyewitnesses, is relevant to prove that the conduct of the person or organization on a particular occasion was in conformity with the habit or routine practice.

This rule only makes sense if the conduct in question was contemporaneous with or subsequent to the establishment of a routine practice. If the routine practice did not exist at the time of the alleged conduct, but rather was a routine practice allegedly established years later, then the prior conduct cannot be in conformity with what was at the time non-existent routine practice It was error for the trial court to admit

those loan documents and consider that as evidence in determining that Key had not met its burden of proof that the loans were for a business purpose. The only other loan document that was relevant to a "routine practice" in the period 2000 to 2002 was Carlson's promissory note payable to Gary Dahlby in 2001, (EX 80), which was in the same form used by Key and did not contain any "business purpose" provision. Carlson, however, admitted that the loan from Dahlby was indeed for a business purpose. RPI 56.

C. The Washington legislature did not intend the usury statute to apply to persons who were not, by adversity and necessity of economic life driven to borrow money at any cost.

The trial court found that

> At the loans from the Plaintiff were made in 2000 and 2002. the Defendants were not needy borrowers who by adversity and necessity of economic life, were driven to borrow money at any cost from an unconscionable money lender. The Defendants were not desperate in 2000 and 2002 at the time they borrowed the money. The Defendants had the ability to move and transfer assets and possessions and property and were not one(sic) the door of destitution at that time.

CP 177, FF 21.

In 1988, the Washington Supreme Court, in Brown v. Giger, 111 Wn.2d 76, 757 P.2d 523 (1988), discussed the evolution of the "business purpose" exemption to the usury statute.

> Washington's usury statutes, like those of other states, are designed "to protect the needy borrower from the unconscionable

money lender" by prohibiting interest charges that exceed a statutory maximum. *Sparkman & McLean Co. v. Govan Inv. Trust,* 78 Wn.2d 584, 588, 478 P.2d 232 (1970). "The protection granted is based on the fact that many borrowers are powerless to resist the avarice of the money lenders." *Baske v. Russell,* 67 Wash.2d 268,273, 407 P.2d 434 (1965).

Interest ceilings are not always beneficial, however. Because they limit the availability of credit for high risk enterprises, usury restriction have been criticized as "purposeless control and restraint of business." Note, Usury Legislation – Its Effects on the Economy and a Proposal for Reform, 33 Vand.L.Rev. 199, 219 (1980). Nor are the restrictions always necessary. Corporations, banks and other financial institutions, as well as individual investors, being accustomed to financial operations and familiar with the worth of money in the market from day to day, might well be deemed to require no statutory protection against being forced by their financial necessities to pay excessive interest for moneys borrowed. *Sparkman v McLean,* 78 Wash.2d at 589, 478 P.2d 232 *(quoting Griffith v. Connecticut,* 218 U.S. 563, 570, 31 S.Ct. 132, 54 L.Ed. 1151 (1910)).

Washington's "business purpose" usury exemption, RCW 19.52.080, is responsive to these observations. Since its enactment in 1969, the exemption has removed constraints of the usury restrictions from a steadily broadening class of financial transactions. Until 1975, the exemption denied the defense of usury to certain entities and persons "in the business of lending money or the development or improvement of real estate". Law of 1969, 1st Ex. Sess. ch. 142, § 1, p. 1039; Laws of 1970, 1st Ex. Sess. ch. 97, § 2, p. 762. From 1975 to 1981, the exemption applied to an expanded group of entities and persons with respect to transactions of $50,000 or more made "exclusively for commercial or business purposes". Laws of 1975, 1st Ex. Sess. ch. 180, § 1, p. 616. And since 1981, still more entities fall with the scope of the exemption, and exempt transactions are now those of any amount made "primarily for agricultural, commercial, investment, or business purposes". RCW 19.52.080.

We discern in this steady withdrawal of the usury restraints the Legislature's intent to limit application of the usury laws to

those situations in which the statutory restrictions are most urgently required. The evil at which the usury laws are aimed, as we have said, is oppression of the borrower "who by adversity and necessity of economic life [is] driven to borrow money at any cost." *Baske,* 67 Wash.2d at 273, 407 P.2d 434. One who incurs a debt primarily for agricultural, commercial, investment or business purposes, RCW 19.52.080, is not subject to such oppression, as he does not borrow out of "adversity and necessity of economic life". Thus, RCW 19.52.080 denies to this person the protections against usury.

The exemption is not a mean spirited one, however. Its purpose is positive: to free up credit for those whose ventures count not be financed at below-usury rates. Enacted and expanded during a time of rising interest rates and increasing criticisms of usury restrictions, the "business purpose" exemption functions as an "escape valve - something that would relieve the adverse pressure which the usury laws were exerting on legitimate commercial activities." Shanks, Practical Problems in the Application of Archaic Usury Statutes, 53 Va.L.Rev. 327, 347 (1967).

Brown v. Giger, 111 Wn.2d 76, 79-81, 757 P.2d, 523 (1988) (Emphasis added).[5]

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[5] In its Conclusion of Law No. 22, the trial court characterized the "business purpose" exemption as a "narrow" exemption citing Aetna Finance Co .v. Darwin, 38 Wn. App. 921, 924-25 (1984). The version of the "business purpose" exemption in RCW 19.58.080 at issue in that case only exempted transactions that were "exclusively" for commercial or business purposes. The legislature subsequently amended the business exemption statute to apply to loans made "primarily for agricultural, commercial, investment, or business purposes". As noted above in the lengthy quote from the Supreme Court's decision in Brown v. Giger, the legislature has "has removed constraints of the usury restrictions from a steadily broadening class of financial transactions." The current version of RCW 19.52.080, and the version in effect at the time of the two loan transactions in question, provides in relevant part:

> persons may not plead the defense of usury nor maintain any action thereon or therefor if the transaction was primarily for agricultural, commercial, investment, or business purposes

In that case, Brown and 4 other couples loaned Giger $33,000.00 through a loan broker and Giger in turn loaned that money to a friend by the name of Ebeling who invested the money in a business. The Giger loan to Ebeling was interest free and there was no business advantage to Giger in making that loan. The trial court found that Giger had not made it clear that she had no interest in Ebeling's business and Ebeling had been present at Giger's loan interview. In addition, the loan documents described the loan to Giger as having a business purpose. Brown v. Giger, *supra.* at 81-82.

The trial court granted summary judgment to the lender, but the Court of Appeals found that the loan to Giger, despite the representations in the loan documents, was not for business purposes and reversed the judgment. The Supreme Court reversed the Court of Appeals finding that the loan to Giger was for business purposes and reinstated the trial court judgment. *Id.* at 84.

Although the trial court judgment could have been confirmed solely on the basis of the business purpose representations made by Giger in the loan documents, the Supreme Court went further and noted that "Moreover, nothing suggests that Giger was 'by adversity and necessity ... driven to borrow money at any cost.' Baske, 67 Wash.2d at 273, 407 P.2d. 434." By so ruling, the Supreme Court made it clear that the usury

defense is available only to those who are "by adversity and necessity ... driven to borrow money at any cost." Carlson is not in that category.

This Court in Stevens v. Security Pacific Mortgage Corporation, 53 Wn.App. 507, 768 P.2d 1007 (1989), held that a loan for the purchase of a residential condominium by the borrower was not usurious even though the loan was for a residential condominium. The Court of Appeals found that the promissory note was usurious on its face because it was a loan of money, the principal was repayable absolutely, the interest rate was in excess of that allowed for personal or consumer loans, and Security Pacific knew that the rate charged was usurious for 'non-commercial loans'." Stevens, *supra.* at 515. The court held, however, that the loan was exempt under the business purpose exemption as a matter of law "because the borrower had represented to the lender it was for business purposes and the borrower – Stevens - was not "by adversity and necessity . . . driven to borrow money at any cost." Stevens, *supra.* at 517.

> In the present case, Stevens took advantage of the system to obtain financing for a luxury home that she otherwise would not have been able to obtain, and now seeks to raise the defense of usury. This is not the type of activity that the legislature intended to protect in enacting the usury laws. Accordingly, we find that that this loan falls with the exception for business loans.

Stevens, *supra.* at 517.

Like the borrower in Stevens and Giger, Carlson did not need to borrow money at any cost. When the loans were made, Carlson had numerous personal assets: a home in Ballard, vacation homes in Chelan, Washington and Arizona, unimproved lots in Chelan and Arizona, and an airplane hangar in Chelan. If indeed, Carlson used the loan proceeds to remodel their two vacation homes and to buying an additional vacation home in Canada, these are not the types of "necessity" that would cause a borrower to resort to taking a high interest rate loan. The trial court's finding that Carlson "were not needy borrowers who by adversity and necessity of economic life, were driven to borrow money at any cost from an unconscionable money lender" is clear and dispositive. The usury law was not intended to protect someone in Carlsons' position. It was error for the court to conclude that the loans to Carlson violated the usury statute.

D. Key is entitled to an award of attorneys' fees on appeal.

Both Note 1 and Note 2 contained an attorney's fee clause providing that the prevailing party in a suit to collect the notes would be entitled to attorney's fees and costs. Key requested attorney's fees in its complaint. CP 6-14. RCW 4.84.330 provides:

> In any action on a contract or lease entered into after September 21, 1977, where such contract or lease specifically provides that attorney's fees and costs, which are incurred to enforce the provisions of such contract or

> lease, shall be awarded to one of the parties, the prevailing party, whether he is the party specified in the contract or lease or not, shall be entitled to reasonable attorney's fees in addition to costs and necessary disbursements. Attorney's fees provided for by this section shall not be subject to waiver by the parties to any contract or lease which is entered into after September 21, 1977. Any provision in any such contract or lease which provides for a waiver of attorney's fees is void. As used in this section "prevailing party" means the party in whose favor final judgment is rendered.

Key is entitled to recover its fees on this appeal.

V. CONCLUSION

For ten years between 2000 and 2010 payments were religiously made on the loans by checks drawn on the business checking accounts of Carlsons' company, Northwest Seaplanes, Inc. or San Juan Airlines. Every payment was made on a business check. The only testimony on the intent of the borrower in requesting the loan was from the lender and that it was represented by Clyde Carlson that each of the loans was for a business purpose. The evidence at trial indicated that during 2001 to 2002, Mr. Carlson made loans to his corporation and either owned or purchased airplanes.

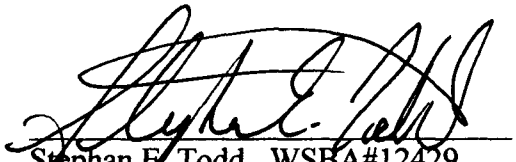
More importantly, the Washington Supreme Court has made it clear that the usury statute is intended only to apply to those **who by adversity and necessity of economic life [is] driven to borrow money**

at any cost. Carlson is not such a borrower as the trial court found in its unchallenged finding of fact number 21.

All of the evidence at trial pointed to only one conclusion: the loans from Key were for a business purpose. Like the borrower in the Stevens case, Carlson, with all of their vacation homes, airplanes and other assets, chose to borrow money that he did not need and eventually did not want to pay back. Carlson should not be able to avoid his obligations by raising the usury defense.

The court should reverse the trial court, remand for entry of judgment for Key on the promissory notes, including attorney's fees and costs at trial, and award Key its attorney's fees incurred on this appeal.

RESPECTFULLY SUBMITTED this 9th day of September, 2015.



Stephan E. Todd WSBA#12429
Attorney for Appellant Key
Development Pension