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COURT OF APPEALS
DIVISION II

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STATE OF WASHINGTON

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No. 47224-4-II

COURT OF APPEALS
DIVISION II
OF THE STATE OF WASHINGTON

SHASTA APARTMENTS, LLC, CHARLES R. JOHNSON, II AND
ELIZABETH A. JOHNSON,

Appellants,

v.

UMPQUA BANK,

Respondent.

APPELLANTS' OPENING BRIEF

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COME NOW Appellants, Shasta Apartments, LLC (“Shasta”) and Charles Johnson, II and Elizabeth A. Johnson, and their marital community, (collectively, the “Johnsons”), and hereby submit Appellants’ Opening Brief.

I. INTRODUCTION

This appeal addresses the fact that Umpqua chose to foreclose its real estate collateral through a general receivership in an attempt to craft a combination of impermissible remedies – preserving Umpqua’s right to a deficiency and extinguishing Shasta’s and the Johnsons’ right to redeem the real estate. (CP 198). Such a result is contrary to Washington law and the long-standing policies upon which it is based.

On March 19, 2012, Umpqua commenced a general receivership. (CP 1-35). The aim of the receivership was to compel the sale of real estate securing a loan Umpqua’s predecessor had made to Shasta, which was in default. (CP 5-6). Through the receivership initiated by Umpqua, a receiver was appointed. (CP 98-104). The receiver sold Shasta’s real estate free and clear of all liens and all rights of redemption. (CP 198). Subsequently, Umpqua sought to recover an alleged deficiency against its borrower Shasta and the guarantors of the loan, i.e. the Johnsons. (CP 238). Though Umpqua chose to initiate a receivership, Umpqua had the option of foreclosing on Shasta’s real estate using a judicial foreclosure as

set forth in RCW 61.12. Notably, under RCW 61.12, the right to pursue a deficiency judgment is preserved as a corollary to the debtor's right to redemption. Umpqua could have also foreclosed on Shasta's real estate nonjudicially pursuant to RCW 61.24 and sought a limited right to a deficiency against the Johnsons pursuant to RCW 61.24.100.

The right to seek a deficiency is a creature of statute in Washington. In electing one remedy, a party must forgo others along with their respective benefits and drawbacks. In short, Umpqua elected and effectuated the sale of Shasta's real estate through a receivership and the result of such election is that Umpqua is not entitled to seek a deficiency judgment against its borrower, Shasta, or the guarantors, the Johnsons. Washington's Receivership Act simply does not provide a right to a deficiency. Moreover, the price paid by Umpqua in eliminating Shasta and the Johnsons' right of redemption is the loss of Umpqua's right to seek a deficiency against Shasta and/or the Johnsons.

The parties filed cross motions for summary judgment on the issue of Umpqua's right to a deficiency judgment. (CP 368, 337). The trial court denied Shasta and the Johnsons' motion and granted Umpqua's motion, entering judgment against Shasta and the Johnsons for the approximate amount of \$933,000. (CP 511, 499). This appeal timely followed.

II. ASSIGNMENT OF ERROR AND ISSUES RELATING TO ASSIGNMENT OF ERROR

Shasta and the Johnsons make the following assignment of error:

The trial court erred by granting Umpqua's Motion for Summary Judgment against Shasta and Default Judgment against the Johnsons, awarding judgment in favor of Umpqua against Shasta and the Johnsons, denying Shasta and the Johnsons' Motion for Summary Judgment, and entering Final Judgment in favor of Umpqua against Shasta and the Johnsons where Umpqua sold its collateral under the Receivership Act and such Act does not provide any right to a post-sale deficiency and the sale terminated Shasta's right of redemption.

Issues relating to the assignment of error:

Issue #1: Does Umpqua have a legal right to pursue a deficiency judgment against Shasta and the Johnsons after Umpqua elected to sell Shasta's Property at a general receiver's sale pursuant to Washington's Receivership Act?

Answer: No, because the right to seek a deficiency judgment is purely statutory and Washington's Receivership Act provides no such right.

Issue #2: Does Umpqua have a legal right to pursue a deficiency judgment against Shasta and the Johnsons after Umpqua elected to sell Shasta's Property at a general receiver's sale free and clear of Shasta's right to redemption?

Answer: No, because under Washington State's foreclosure system, after Umpqua took away Shasta's right to redemption, Umpqua forfeited its right to a deficiency judgment, unless some statutory exception were to apply, which is not the case here.

III. STATEMENT OF THE CASE

A. Background Facts

On June 15, 2007, Shasta executed a promissory note with Evergreen Bank (“Evergreen”) in the principal amount of \$581,226.45. (CP 271). The promissory note was secured by a deed of trust (the “Deed of Trust”) encumbering real estate on the same date owned by Shasta. (CP 384). The property was located at 1545 South Fawcett Avenue, Tacoma, Washington (the “Property”). (CP 384). Shasta executed a second promissory note (the “Note”) dated August 6, 2009 in favor of Evergreen with a principal balance of \$1,055,271.51. (CP 380-383). On January 25, 2010, Umpqua acquired the Note and related security documents from Evergreen. (CP 273). Charles R. Johnson, II executed a commercial guaranty on August 6, 2009 in favor of Evergreen and a second commercial guaranty on January 28, 2011 in favor of Umpqua (collectively, the “Guaranties”). (CP 394-397, 399-402) Subsequently, Shasta defaulted under the Note and on March 19, 2012, Umpqua filed a petition (the “Petition”) with the Pierce County Superior Court seeking the appointment of a general receiver to ultimately sell the Property and/or judicially foreclose the Property. (CP 1). The trial court entered an order, in the form proposed by Umpqua, appointing a general receiver (the

“Receiver”) on April 6, 2012. (CP 98). In that order, the trial court entered conclusions of law, including the following:

2. The terms of the Deed of Trust entitle Umpqua Bank to the appointment of a general receiver for the Property upon Shasta Apartments’ default under the Replacement Note and Loan Documents.

3. Under RCW 7.60.025, this Court has the authority to specifically enforce those provisions of the Deed of Trust which entitle Umpqua Bank to the appointment of a general receiver.

(CP 1002). The trial court’s order also provides as follows: “The Receiver’s sale of any collateral property shall be effected free and clear of liens and of all rights of redemption, whether or not the sale will generate proceeds sufficient to fully satisfy all claims secured by the property.” (CP 101).

On July 26, 2013, the Receiver filed a motion to approve its sale of the Property free and clear of liens and of all rights of Shasta to redemption. (CP 238). On August 9, 2013, the trial court entered an order again, in the form proposed by Umpqua, approving the sale of the Property free and clear of liens and of all rights of Shasta to redemption. (CP 238). The order also characterized the sale as an execution pursuant to RCW 82.45.010(3)(i) and therefore exempt from excise taxes. (CP 238). By pursuing foreclosure through the receivership and characterizing the foreclosure as an execution sale, Umpqua received the following

benefits: (1) sale of the Property free of the cloud of Shasta's right to redeem and (2) exemption from excise tax. (CP 236, 238). Notably, the order appointing the receiver and the order approving the sale make no mention of the right to pursue a deficiency. (CP 101, 238).

B. Procedural History

On November 14, 2014, Shasta and the Johnsons filed a Motion for Summary Judgment. (CP 368). Umpqua also filed a Motion for Summary Judgment and for Entry of Default Judgment on the same date. (CP 337). The trial court heard oral argument on December 12, 2014 on both motions. (RP December 12, 2014 at pgs. 3-13). The trial court denied Shasta and the Johnsons' motion and granted Umpqua's motion. (RP December 12, 2014 at pgs. 1, 13; CP 511, 499). Shasta and the Johnsons subsequently timely filed this appeal.

In its summary judgment briefing, Umpqua argued that the Johnsons were precluded from making any arguments relative to liability due to the entry of default against them. (CP 466-467). However, it is apparent from the verbatim transcript that the trial court properly reached the merits of the Johnsons' argument despite the entry of a default order, because a default judgment had not been entered and the validity of such a judgment was at issue. (RP December 12, 2014 at pgs. 3-13).

IV. ARGUMENT

A. The Standard of Review for Summary Judgment Is De Novo.

On summary judgment, the appellate court reviews the motion *de novo*. Davis v. Fred's Appliance, Inc., 171 Wn. App. 348, 287 P.3d 51 (2012). Summary judgment is proper where the pleadings, depositions, answers to interrogatories, and admissions show that the moving party is entitled to judgment as a matter of law. CR 56(c); Young v. Key Pharm., Inc., 112 Wn.2d 216, 226, 770 P.2d 182 (1989). On appeal of a summary judgment order, the appellate court performs the same inquiry as the trial court. Jones v. Allstate Ins. Co., 146 Wn.2d 291, 300, 45 P.3d 1068 (2002); *see also* Bostain v. Food Express, Inc., 159 Wn.2d 700, 708, 153 P.3d 846 (2007).

Questions of fact may be determined as a matter of law where reasonable minds could reach but one conclusion. Sherman v. State, 128 Wn.2d 164, 184, 905 P.2d 355 (1996); *see also* Kim v. Budget Rent A Car Systems, Inc., 143 Wn.2d 190, 203, 15 P.3d 1283 (2001).

Here, summary judgment is appropriate where the issues presented reflect questions of law.

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B. The Trial Court Erred by Denying Shasta and the Johnsons' Motion for Summary Judgment Where the Receivership Act Provides No Statute Permitting Umpqua to Pursue a Deficiency Judgment and the Sale of Shasta's Property Free of Any Right of Redemption Eliminates any Corollary Right to Pursue a Deficiency Judgment.

1. Deficiency Judgments Are Created Solely by Statute and the Receivership Act Does Not Provide for Such a Right. Consequently, Umpqua Had No Right to Obtain a Deficiency Judgment Against Shasta and the Johnsons.

A secured creditor makes an election of remedies when its debtor defaults. A secured creditor may (1) non-judicially foreclose (RCW 61.24); (2) judicially foreclose (RCW 61.12); (3) sue on the promissory note and/or any guaranties and seek a money judgment (RCW 61.24.100(2)(a)); or (4) seek the appointment of a general receiver to sell the property (RCW 7.60). Foreclosure and deficiency rights are exclusively provided by statute in Washington. *See* RCW 61.24, 61.12, and 7.60. The right to a deficiency judgment in Washington is purely statutory. *See* Washington Mut. Sav. Bank v. United States, 115 Wn.2d 52, 57, 793 P.2d 969 (1990) *clarified on denial of reconsideration*, 800 P.2d 1124 (Wash. 1990); *see also* Bank of Hemet v. United States, 643 F.2d 661, 667 (9th Cir. 1981) and Bradley Engineering and Machinery Co. v. Muzzey, 54 Wn. 227, 229, 103 P. 37 (1909) (“[T]he general rule is that a court of equity has no power to enter a deficiency judgment in an action to foreclose a mortgage unless authorized so to do by statute or rule of

court.”); *see also* RCW 61.12.070-080. Once a particular foreclosure process is chosen by a secured creditor, such creditor activates the entire statutory process chosen and the policies embodied therein, and not just parts of the process that the creditor finds useful. As a foreclosure process, the Receivership Act (RCW 7.60) does not provide a right to a deficiency judgment.

Here, Umpqua sought and obtained the appointment of a general receiver to sell the Property. In choosing such foreclosure route, Umpqua made the deliberate choice to be bound by the limitations imposed on it by the Receivership Act. Thus, in electing to sell the Property through the receivership rather than foreclosing on the Property pursuant to RCW 61.12 and seeking a statutory right to deficiency or foreclosing on the Property pursuant to RCW 61.24 and seeking a statutory exception to pursue a deficiency against the Johnsons under RCW 61.24.100, Umpqua elected a remedy that does not preserve the right to a deficiency judgment. There is simply no authority in Washington permitting the preservation of a deficiency unless authorized by statute and no such statute exists under the Receivership Act. Consequently, Umpqua had no right to pursue a deficiency against Shasta and/or the Johnsons after the receivership sale and this Court should reverse the trial court’s grant of summary judgment

and final judgment in favor of Umpqua and enter summary judgment in favor of Shasta and the Johnsons.

2. Umpqua Was Not Permitted to Seek a Deficiency against Shasta and the Johnsons Because the Property Was Sold Free and Clear of any Rights of Redemption.

As provided above, a foreclosure sale may be carried out in Washington under three separate acts -- RCW 61.12, 61.24, or 7.60. These different foreclosure methods come with compromises. A party that judicially forecloses real estate (RCW 61.12) is entitled to seek a deficiency, but the real estate is subject to the right to redemption provided in RCW 6.23. Nonjudicial foreclosure (RCW 61.24) is quicker and less expensive and does not provide a right to redemption, but this efficiency comes at a price (i.e., the loss of the right to seek a deficiency, except in limited circumstances prescribed by RCW 61.24.100). Here, Umpqua, chose the third path (RCW 7.60) in an attempt to avail itself of the benefits of seeking a deficiency judgment while also still entitling it to sell the Property free of redemption rights. Such a remedy is not permitted under Washington's well-established foreclosure process. The remedies Umpqua combined in this action -- removing any right to redemption under the Receivership Act while retaining the right to a deficiency judgment -- are simply not available under Washington law.

In electing to have the Property sold through a general receivership, Umpqua deprived Shasta (and the Johnsons by assignment) of an essential protection available under the law following a judicial foreclosure of Shasta's Deed of Trust, specifically the right of redemption. "The right of the obligor-mortgagor to free his land from the mortgage by discharging the obligation is a most sacred right; this is obvious." 18 Washington Practice, Real Estate § 17.6. The existence of the right of redemption is a condition precedent to a deficiency judgment. 27 Washington Practice, Creditors' Remedies-Debtors' Relief § 3.6. As provided in Washington Practice, "[i]n a sense, the ability to obtain a deficiency judgment is 'paid for' by the requirement of a redemption period." Id.

Here, in electing to have a general receiver appointed and to not pursue a judicial foreclosure under RCW 61.12, Umpqua both avoided the costly and lengthy redemption period and deprived Shasta and the Johnsons of their statutory right of redemption following a judicial foreclosure sale. The Receivership Act does nothing to alter the long-standing law of Washington providing that where a foreclosure is not accompanied by redemption rights, the resulting trade-off is to extinguish the right to a deficiency judgment. There is no compelling reason in this case to alter the long-standing balance of rights struck between creditor

and debtor established by the Legislature. The result Umpqua obtained here is simply not permitted under Washington law or supported by policy. Umpqua secured the benefit of a sale without the risk of redemption by Shasta and the Johnsons, a right which can only be extinguished in specific ways, under limited circumstances, i.e. pursuant to RCW 61.24. Under Washington law, the elimination of the right of Shasta and the Johnsons to redemption is paid by Umpqua forfeiting its potential right to pursue a deficiency.

Moreover, Washington Courts have acknowledged this trade off of obligations and benefits relative to executing on collateral repeatedly.

In Thompson v. Smith, 58 Wn. App. 361 (1990), the court found:

Here, by accepting the deed in lieu of foreclosure from Israel and then privately selling the property, Thompson essentially carried out a nonjudicial foreclosure without having to follow the statutory procedures of RCW Ch. 61.24. Had he foreclosed nonjudicially pursuant to the statute, he would have been barred from seeking a deficiency judgment on the underlying obligation. Given the policies underlying RCW Ch. 61.24, we can find no authority for permitting Thompson to obtain through self-help that which he could not accomplish pursuant to RCW Ch. 61.24. Under the specific circumstances of this case, Smith is entitled to the protection of RCW 61.24.100.

58 Wash. App. at 366. Although Thompson does not deal with a receivership, the analysis underpinning the court's reasoning implicates the same trade-off between the benefits and obligations relative to various

methods of foreclosure as presented in this case. Like the litigant in Thompson, Umpqua sought remedies not available after a sale of property pursuant to the Receivership Act, namely preservation of a right to a deficiency judgment. In Thompson, the Court held that parties may not craft “self-help” remedies to avoid the protections afforded debtors under RCW 61.24.

Finally, to permit Umpqua to pursue a deficiency where it elected to have a receiver sell the Property instead of a trustee under RCW 61.24 would render Washington’s Deed of Trust Act superfluous by allowing deficiencies against borrowers and guarantors alike without requiring the statutorily-mandated procedures and protections afforded under Washington’s Deed of Trust Act. The very purpose of Washington’s Deed of Trust Act (i.e., to avoid court action and streamline an efficient and inexpensive nonjudicial process to realize on real estate security interests) would be undermined by allowing lenders to disregard numerous obligations imposed upon trustees and protections afforded to guarantors in the sale of collateral secured by a deed of trust. Specifically, Washington’s Deed of Trust Act provides the following obligations and protections: (1) it describes and defines “fair value” of property encumbered by a deed of trust (RCW 61.24.005(6)); (2) it requires strict adherence to statutory notice requirements (RCW 61.24.040; *see also*

Rucker v. Novastart Mortgage, Inc., 177 Wn. App. 1 (2013)); (3) it imposes a duty of good faith owed to guarantors (RCW 61.24.005(3)); (4) it provides recourse to contest any alleged default (RCW 61.24.030(8)(j); RCW 61.24.130); (5) it provides for the right to stop the sale by paying amounts due and owing (RCW 61.24.040(1)(e)); (6) it requires that notice be provided to guarantors (RCW 61.24.042); (7) it provides for the right to a fair value hearing (RCW 61.24.042; RCW 61.24.100(5)); (8) it provides for the right to restrain the sale (RCW 61.24.130); and (9) it provides for the right to pursue a deficiency judgment against a guarantor (RCW 61.24.042; RCW 61.24.100(3)(c)). None of these obligations and protections are provided in the Receivership Act.

Here, Umpqua created its own foreclosure process and utilized the remedies benefitting Umpqua without the balance of preserving Shasta and the Johnsons' right to redeem the Property and the other protections they would be afforded under RCW 61.24. Each foreclosure process provides the creditor and debtor with certain rights and obligations. Umpqua cannot be permitted to avoid the statutory methods and the restrictions that accompany those methods by cobbling together the most favorable aspects of various methods of foreclosure. This is simply not permissible under Washington law and the summary judgment and

judgment entered in Umpqua's favor should be reversed and summary judgment should be entered in favor of Shasta and the Johnsons.

V. REQUEST FOR ATTORNEY FEES AND COSTS

Pursuant to RAP 18.1, the Deed of Trust, and the Guaranties, Shasta and the Johnsons request an award for attorney fees and costs and the reversal of the award to Umpqua of its attorney fees and costs. Under RAP 18.1, a party may recover attorney fees "[i]f applicable law grants to a party the right to recover reasonable attorney fees or expenses." RAP 18.1. The Deed of Trust and Guaranties provide for attorney fees and costs. (CP 384, 394, 399). Pursuant to RCW 4.84.330, the attorney fees provisions in the Deed of Trust and Guaranties are reciprocal and Shasta and the Johnsons are entitled to recover the attorney fees and costs they have incurred in defending this suit and pursuing the instant appeal based on the prevailing party clause contained in the parties' contract. *See also, Draper Machine Works, Inc. v. Hagberg*, 34 Wn. App. 483, 490 (1983).

VI. CONCLUSION

Shasta and the Johnsons respectfully request this Court to: (1) reverse the trial court's grant of Umpqua's Motion for Summary Judgment against Shasta, Default Judgment against the Johnsons, and the award of judgment in favor of Umpqua against Shasta and the Johnsons; (2) reverse and vacate the trial court's grant of Final Judgment in favor of Umpqua

against Shasta and the Johnsons; (3) grant Shasta and the Johnsons' Motion for Summary Judgment against Umpqua; and 4) grant Shasta and the Johnsons' prevailing party attorney fees and costs incurred both on appeal and in the trial court and reverse the award of such fees and costs to Umpqua below.

DATED this 27th day of July 2015.

MCGAVICK GRAVES, P.S.

By:



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Of Attorneys for Appellants

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DECLARATION OF SERVICE

The undersigned declares under the penalty of perjury under the laws of the State of Washington that I am a citizen of the United States, a resident of the State of Washington, over the age of eighteen years, not a party or interested in the above-entitled action, and competent to be a witness herein.

On the date given below, per the electronic service agreement of the parties, I caused to be served via E-Mail and further via ABC Legal Messengers, a copy of the foregoing Appellants' Opening Brief to:

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Signed at Tacoma, Washington this 27 day of July 2015.

McGAVICK GRAVES, P.S.

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