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No. 63321-0-1

**COURT OF APPEALS, DIVISION 1
OF THE STATE OF WASHINGTON**

FREESTONE CAPITAL PARTNERS L.P.; FREESTONE LOW
VOLATILITY PARTNERS LP; FREESTONE CAPITAL QUALIFIED
PARTNERS L.P.; and FREESTONE LOW VOLATILITY QUALIFIED
PARTNERS LP,

Respondents,

v.

MKA REAL ESTATE OPPORTUNITY FUND I, LLC, a California
limited liability company; MKA CAPITAL GROUP ADVISORS, LLC, a
California limited liability company; MICHAEL A. ABRAHAM, an
individual; and JASON SUGARMAN, an individual,

Appellants.

**REPLY BRIEF
OF APPELLANTS MICHAEL ABRAHAM, JASON
SUGARMAN, AND MKA REAL ESTATE
OPPORTUNITY FUND I, LLC.**

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I. ARGUMENT IN REPLY

A. THE GUARANTORS' SCANT PERSONAL CONTACT WITH WASHINGTON IS INSUFFICIENT TO ASSERT PERSONAL JURISDICTION

The case for personal jurisdiction is deficient. The Guarantors' contacts with Washington in their *personal* capacities is nonexistent. The single "contact" is the Plaintiffs' Washington location. This Court should reject personal jurisdiction for lack of minimum contacts concerning the guarantees, and for lack of fairness.

This Court must evaluate what contacts with Washington the Guarantors had in their personal capacities. Contacts made in an official capacity do not support personal jurisdiction. The contacts on which Plaintiffs rely are insufficient because the Guarantors' capacities were official, not personal. Plaintiffs did not dispute that this Court must determine whether a preponderance of evidence supports personal jurisdiction. It does not. This Court should reverse for lack of personal jurisdiction due to insufficient minimum contacts.

The Court's inquiry of jurisdiction is case-by-case as conceded by Plaintiffs at p. 13 in their brief. Plaintiffs examples of decisions from Washington and other jurisdictions are based necessarily on different facts, and are not conclusive. The Court must scrutinize the minimum contacts, and it must decide if traditional notions of fair play are offended

by the particular exercise of jurisdiction. Guarantors have shown the primacy of California in the transaction before this Court. Guarantors have shown that the Plaintiffs never personally asked them for guarantees, and that the guarantees were drafted, presented and signed in California. No evidence exists in the record of any communication regarding the guarantees between the Guarantors and Plaintiffs' representatives, except Plaintiffs' demand letter sent to California. Regarding the guarantees, the Guarantors had no personal contacts with Washington. Plaintiffs are located in Washington. This fact alone should not convince this Court to exercise jurisdiction.

Traditional notions of fair play would be offended by the particular exercise of jurisdiction in this instance. Plaintiffs do not dispute that the burden on these Guarantors to litigate in their personal capacities in Washington is great. The quality, nature and extent of the Guarantors' personal contacts with Washington being poor, the equities do not weigh in favor of jurisdiction.

B. THE TRIAL COURT ERRED IN FAILING TO CONDUCT A CHOICE OF LAW ANALYSIS AND APPLY CALIFORNIA LAW TO THE GUARANTEES

This Court should reverse the judgments against the Guarantors because the trial court applied Washington law instead of California law. The trial court incorrectly ruled that the Guarantors consented to

Washington law. The record does not support this. Only the principal consented to Washington law. The guarantees were silent on choice of law. This requires reversal and remand for further proceedings. A choice of law analysis compels the conclusion that California law should apply.

1. The record does not support the trial court's conclusion that the Guarantors consented to Washington law.

The guarantees contain no choice of Washington law. CP 630. Plaintiffs concede that a note and a guaranty can be governed by different laws. *Resp. Brf*, p. 23. The trial court ruled that the *principal's* consent to Washington law in the promissory notes supplies the missing consent of the Guarantors. Plaintiffs attempt to support this ruling by calling this Court's attention to Abraham's acknowledgement that *the promissory notes* call for the application of Washington law. *Resp. Brf*, p. 22. This is irrelevant to whether *the guarantees* call for the application of Washington law to the Guarantors' obligations. They do not. Upon this Court's *de novo* review of the proper construction of the guarantees, it should hold that the Guarantors did not consent to application of Washington law for the obligations created by the guarantees.

The trial court held that the Guarantors necessarily consented to Washington law because the guarantees appear on the same paper as the notes. The trial court integrated without basis the choice of law provision

in the notes to the guarantees. This is contrary to *Robey v. Walton Lumber Co.*, 17 Wn.2d 242, 255, 135 P.2d 95 (1943), a case which explains the separateness of the documents. Plaintiffs argue that the Guarantors “executed” and “signed” the notes and should be bound by the choice of law in the notes. *See Resp. Brf*, p. 22. They fail to distinguish the different capacities of the Guarantors. Abraham and Sugarman signed the notes as officers and agreed to Washington law on *behalf of MKA*. They signed the guarantees in their personal capacity, in which they did not agree to any states’ laws.¹ This Court must examine what the Guarantors agreed to as guarantors in their personal capacities. That examination should compel this Court to reverse.

Plaintiffs also err in stating that documents were drafted by “[the Guarantors’] own counsel.” *Resp. Brf*, p. 21. The record is clear that the Guarantors had no counsel. CP 258 13:13-17, 259 14:4-5 (Abraham); CP 283 13:2-5 (Sugarman). Plaintiffs incorrectly characterize MKA’s counsel as the Guarantors’ counsel when in truth the Guarantors had no counsel guarding their personal interests.

¹ In fact, the Note Extension Agreement[s] acknowledges pertinent California law, California Civil Code § 1542. CP 666 at ¶ 12. A contract’s reference to legal doctrines that are peculiar to the law of a particular state indicates the parties’ preferred choice of law. *Shannon-Vail Five Inc. v. Bunch*, 270 F.3d 1207 (9th Cir. 2001), citing Restatement § 187 cmt. a.

As an alternative ground to support the trial court, Plaintiffs argue that the Guarantors consented to Washington law in the note extension documents. *Resp. Brf*, p. 22. This is not substantiated by the documents, which are too narrow to establish such consent. The notes were first extended by the Note Extension Agreement[s]. CP 666-73 (Appendix 3 to Opening Brief). This document contains no choice of law provision. As noted in note 3 above, the Note Extension Agreement[s] acknowledges pertinent California law, California Civil Code § 1542, indicating the parties' expectation that California law would apply. The Note Extension Agreement does *not* contain the Guarantors' consent to Washington law.

The parties then amended the Note Extension Agreements twice, in the First Amendment to the Note Extension Agreement and the Second Amendment[s] to Note Extension Agreement[s]. *See, e.g.*, CP 710-13 (App. 4 to Opening Brief). First, these amendments were drafted by Plaintiffs and should be construed against them, a proposition first raised in the Opening Brief and not disputed by Plaintiffs. *See Opening Brief, p. 42, citing* CP 1077; 1082, ¶ 3; *Forbes v. Am. Bldg. Maint. Co. W.*, 148 Wn. App. 273, 288, 198 P.3d 1042 (2009). Further, these brief amendments adjusted the due dates. CP 710, ¶ 1. After adjusting the due dates, the amendments stated, "No further amendment. Except as expressly modified by this First Amendment, the Note Extension

Agreement shall remain unmodified and in full force and effect and the parties hereby ratify their respective obligations hereunder.” CP 710, ¶ 2. Nothing called the Guarantors’ attention to any new choice of law provision for enforcement of the guarantees.

Plaintiffs cite to a closing paragraph of the extension that contains a choice of law provision limited to the *amendments* themselves. Plaintiffs provide an incomplete citation of that provision. The provision states in full, “5. Governing Law. *This First Amendment* and the rights and obligations of the parties *hereto* shall be construed and interpreted in accordance with the laws of the State of Washington, excluding its conflicts of laws provisions.” CP 713 at ¶ 5 (emphasis added). By its terms, the extension requires only that the *extensions* are governed by Washington law.² To rule otherwise would make the terms “This First Amendment” and “hereto” surplusage.

² The Restatement recognizes that courts perform conflict of laws analysis issue by issue. Restatement (Second) of Conflicts of Law, § 188 cmt. d (“The courts have long recognized that they are not bound to decide all issues under the local law of a single state. . . . Each issue is to receive separate consideration if it is one which would be resolved differently under the local law rule of two or more of the potentially interested states.”). The issue regarding pursuit of the guaranty before pursuit of the principal obligation can be determined by California law while other issues, including hypothetically any issue presented by the amendments to the Note Extension Agreement[s], could be determined by Washington law.

The limited amendments did not specify that the terms of the guarantees would be construed under Washington law or that the parties were amending the guarantee obligations in any material respect other than with regard to the due dates. If Plaintiffs had wished Guarantors to consent to Washington law for enforcement of the guarantees, they should have presented Guarantors a choice of law provision to that effect. They never did. They seek to add such language now. Abraham and Sugarman never agreed to Washington law.

2. Washington's conflicts of law rules support application of California law in these circumstances.

The trial court never performed a conflict of law analysis. It should have, and it should have applied California law. Plaintiff's Supreme Court authorities *Potlatch No. 1 Federal Credit Union v. Kennedy*, 76 Wn.2d 806, 459 P.2d 32 (1969), and *Granite Equipment Leasing Corp v. Hutton*, 84 Wn.2d 320, 325-326, 525 P.2d 223 (1974), support the Guarantors' position that Washington examines which state has "the most significant relationship" to the guarantees to determine which state's law to apply. In this case, if the Court undertakes that analysis prior to remand, that state is California.

Guarantors argued that the Court should apply "the most significant relationship" test of Restatement (Second) of Conflicts of Laws

§ 188. *Opening Brief*, pp. 30-32. This test requires evaluation of specified contacts in light of the policies of the states to determine which state has the most significant relationship to the guarantees and to the issue whether Plaintiffs can enforce the guarantees prior to enforcing the principal obligation. Washington courts emphasize that the contacts are not merely counted, but that the court scrutinizes the interests and public policies of the potentially concerned states. *Granite Equipment Leasing Corp v. Hutton*, 84 Wn.2d at 325-26. Guarantors argued that this analysis should result in application of California law.³ Plaintiffs do not engage in any analysis of the contacts or policies of the relevant states.

Plaintiffs instead argue that a different Restatement section applies, i.e. § 194, one that presumptively applies the law governing the principal

³ In 1939, California enacted legislation to protect guarantors the same as sureties, and to abolish a distinction between the two. *American Guaranty Corp. v. Stoodly*, 230 Cal. App. 2d 390, 392 (Cal. App. 2d Dist. 1964), citing Cal. Civ. Code § 2787. This entitled guarantors to protections that had been developed in equity and codified for sureties in Cal Civ. Code §§ 2845 and 2849. *Id.* at 392-93. The protections include the Guarantors right to require that lenders first pursue the principal and secured interests. *Id.*, citing Cal. Civ. Code §§ 2845, 2849. These provisions of the California Code are unmatched in Washington, where the legislature has taken no action in this area. The guarantors are located in California, making California's policy choice critical to their protection and establishing California's significant interest. California also requires lenders to obtain a license from the commissioner. *Id.* at p. 31. The guarantees were drafted, presented and signed in California. The deal originates from development of real estate in California. Plaintiffs reached out to California.

obligation “which the suretyship was intended to secure.” *Resp. Brf.*, p. 24, citing Restatement (Second) of Conflicts of Laws § 194. Washington has not adopted § 194. Washington specifically applies § 188 to guaranties. But, even application of § 194 would result in application of California law in these circumstances.

Washington applies § 188 to guaranties. This is set forth in the very Supreme Court case cited by Plaintiffs. In *Granite Equipment Leasing Corp.*, the *Granite Equipment Leasing* court stated that “the most significant relationship” test applies to guarantees, explaining,

Washington has adopted the view that, absent a choice of law by the contractual parties, the validity and effect of a contract are governed by the law of the state which has **the most significant relationship to the contract**, except as to the questions of usury and details of performance. . . . **This rule has been specifically extended to contracts of suretyship or guaranty.**

Granite Equipment Leasing Corp v. Hutton, 84 Wn.2d at 324-25 (emphasis added), citing *Potlatch No. 1 Federal Credit Union v. Kennedy*, *supra*. The court analyzed which state’s laws should apply to the guaranty at issue pursuant to § 188. *Id.* at 324-27 (“Factors which may be significant in regard to a guaranty contract include the place of contracting, negotiation and performance; the location of the contract subject matter; and the domicile, residence, and place of business of the parties.”). Consideration should be given “to the interests and public

policies of potentially concerned states as they relate to the transaction in question.” *Id.* at 324-25. *Granite Equipment Leasing* supports this Court’s analysis pursuant to § 188 and the “most significant relationship” test.

Plaintiffs curiously cite *Potlatch No. 1 Federal Credit Union v. Kennedy*, 76 Wn.2d at 809-10, for the proposition that § 194 and not § 188 applies. *See Resp. Brf*, p. 24. *Potlatch* does not support that proposition. The *Granite Equipment Leasing Corp.* court cited to *Potlatch* as authority that the “most significant relationship” test applies to guaranties. *Potlatch* concerns a marital community’s liability as co-signers on a promissory note. *Potlatch* identified Washington’s adoption of “the most significant relationship to the contract” test for determination of conflicts of law issues concerning contracts. The *Potlatch* court set forth § 188 as “a summary” of Washington’s approach. *Id.* at 809. After setting forth the § 188 test, the *Potlatch* court stated, “Normally, these same factors determine the law applicable to suretyship contracts.” *Id.* at 809-10, citing § 194. Rather than state that § 194 controls over § 188, the *Potlatch* equated the factors in both sections. Washington decisions unanimously apply the “most significant relationship” test to guaranties. This Court should apply that test, the outcome of which supports reversal and remand for application of California law.

This Court should also note the Restatement principle that “the protection of the justified expectations of the parties is of considerable importance in contracts whereas it is of relatively little importance in torts.” § 188 cmt. b. *See also* Restatement (Second) of Conflicts of Law § 6(2)(d) (the protection of the justified expectations is a relevant factor). This Court should assign considerable importance to the Guarantors’ justified expectation that California law would apply. Not only did the guarantees not contain a selection of Washington law, but the Note Extension Agreement[s] referred to California law. The Guarantors were unrepresented by counsel. They resided and worked in California, where they executed the guarantees. They justifiably expected California law to apply.

The circumstances of the Subordination Agreement further demonstrate this expectation. Plaintiffs subordinated to Gottex the pursuit of MKA and the secured interests. Guarantors were not parties to the Agreement, nor were their obligations addressed. Their signatures do not appear on that Agreement even on behalf of MKA. Where the parties expected that California law applied to the guarantees, California law would protect the Guarantors from enforcement of their obligations so long as MKA is protected from enforcement of its. That expectation

shaped the parties' subsequent conduct. Unless California law is applied, the Guarantors are hung out to dry.

Differences between § 194 and § 188 do not compel different results in this case. Even if this Court applies § 194, it should find that California has a more significant relationship to the transaction and the parties on the issue of pursuit of the guarantees before pursuit of the principal obligation. The "presumption" in § 194 that law governing the principal obligation should govern the guarantee is subject to the exception that another state's law will be applied "with respect to the particular issue" if the "other state has a more significant relationship under the principles stated in § 6 to the transaction and the parties." Restatement (Second) of Conflicts of Laws, § 194. The section reads in its entirety,

§ 194 Contracts of Suretyship

The validity of a contract of suretyship and the rights created thereby are determined, in the absence of an effective choice of law by the parties, by the law governing the principal obligation which the contract of suretyship was intended to secure, **unless, with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6 to the transaction and the parties, in which event the local law of the other state will be applied.**

Restatement (Second) of Conflicts of Laws § 194 (emphasis added).

Nowhere does the Restatement state circumstances in which that

presumption is “conclusive.” In all circumstances the Court is to evaluate the contacts and attempt to accommodate the factors set forth in § 6.⁴

Either § 188 or the exception of § 194 applies here. California has the most significant relationship to the issue whether Guarantors can require Plaintiffs to pursue first the principals and collateral. It also has the most significant relationship concerning whether the issue whether Plaintiffs’ failure to comply with California Finance Code § 22100 bars this lawsuit. This Court should rule that California law applies to the issue.

3. No false conflict exists because California law permits the Guarantors to require that Plaintiffs first proceed against the principal and collateral in these circumstances; California courts would not find waiver of those protections in the guarantees.

Plaintiffs attempt to support affirmance by arguing the alternative ground that a false conflict is presented between Washington and California law. This argument is meritless for many reasons. Plaintiffs misconstrue California’s statutory scheme and case law. The trial court

⁴ Plaintiffs cut short their quotation from *Ermer v. Case Corp.*, 2002 WL 1796438 at *2 (D. Neb. 2002). In addressing § 194, Nebraska’s *Ermer* court applied the law governing the principal obligation only after stating, “There has been no showing that another state has a materially greater interest in the contract issues.” In this case, unlike in *Ermer*, California has a materially greater interest in the guarantee issues. California law should apply even under § 194.

did not perform this analysis because it presumed without basis that the parties consented to Washington law. If this Court performs the analysis prior to remand, it should conclude that no false conflict exists. California law unequivocally permits the Guarantors to require Plaintiffs proceed first against the principal and the collateral before pursuing guarantors. Under California law, the Guarantors did not waive these protections.

An actual conflict of laws exists where the result is different under the laws of California and Washington. *Seizer v. Sessions*, 132 Wn.2d 642, 649, 940 P.2d 261 (1997). Under California law, a guarantor may insist that the security be exhausted first when the creditor seeks relief against him. Cal. Civ. Code §§ 2845, 2849, 2850; *Moffett v. Miller* 119 Cal. App. 2d 712 (Cal. App. 1953); 1 *Witkin Sum. Cal. Law Contracts* § 1003.

Washington law is substantially different. The parties do not dispute that under Washington law a guarantor may not prevent the creditor from proceeding first against the guarantor. *Warren v. Washington Trust Bank*, 92 Wn.2d 381, 390 n.1, 598 P.2d 701 (1979). A valid conflict of laws exists here. The Court should reverse and remand with instruction to apply California law.

i. California law protects the Guarantors.

California protects guarantors. The California Code permits a guarantor to require a creditor to proceed *first* against the principal or collateral, as follows:

A surety may require the creditor, subject to Section 996.440 of the Code of Civil Procedure [concerning bonds], to proceed against the principal, or to pursue any other remedy in the creditor's power which the surety cannot pursue, and which would lighten the surety's burden; and if the creditor neglects to do so, the surety is exonerated to the extent to which the surety is thereby prejudiced.

Cal. Civ. Code § 2845 (emphasis added). The surety benefits from the security of the principal obligation, as follows,

A surety is entitled to the benefit of every security for the performance of the principal obligation held by the creditor, or by a co-surety at the time of entering into the contract of suretyship, or acquired by him afterwards, whether the surety was aware of the security or not.

Cal. Civ. Code § 2849 (emphasis added). The surety is entitled to have the collateral applied to the obligation *first*, before the surety's own assets are involved, as follows,

Whenever property of a surety is hypothecated with property of the principal, the surety is entitled to have the property of the principal first applied to the discharge of the obligation.

Cal. Civ. Code § 2850 (emphasis added). As stated in note 3, *supra*, the case *American Guaranty Corp. v. Stoody* addresses the history of these code provisions.

Abraham and Sugarman are entitled to these protections. MKA and its property must first answer to Plaintiffs before Plaintiffs pursue Abraham and Sugarman. California law permits Abraham and Sugarman to require this.⁵

ii. Unconditional guaranties are not waivers of Cal. Civ. Code §§ 2845, 2849, and 2850.

The guarantees contain no expression of waiver. Plaintiffs misunderstand the nature of a guaranty and the structure of the California Civil Code regarding a guarantor's right to require pursuit first of the principal and collateral. Plaintiffs argue that based on language in the guarantees, the Guarantors waived their right to insist that the security be exhausted first. *Resp. Brf.* at 28. This argument is premised exclusively on the appearance of the words "unconditional" and "immediately pay" in the guarantees. *Resp. Brf.* at 28. These words are insufficient. They

⁵ Respondents objected to argument on other law besides Cal. Civ. Code sections 2845 and 2849. *Resp. Br.* note 8. This demonstrates Plaintiffs' knowledge and belief that other California laws protect the Guarantors. Respondents, however, raised the false conflict issue in their brief as alternative grounds to support the trial court, so Guarantors may fully reply. Respondents also failed to demonstrate any waiver of Guarantors' cited law.

merely reflect the nature of a guaranty. They do not abrogate the guarantor's rights under the Code.

Plaintiffs' argument is inimical to the California statutory scheme which itself provides that a guarantor is liable "immediately upon default." Cal. Civ. Code § 2807 ("A surety who has assumed liability for payment or performance is liable to the creditor immediately upon the default of the principal, and without demand or notice."). Notwithstanding this language, the Code goes on to permit such a guarantor to require the creditor to proceed against the principal or collateral. Cal. Civ. Code § 2845. *See also Witkin*, § 1003. The words "unconditional" or "immediately pay," therefore, reflect nothing more than the nature of a guaranty under California law. Such words in no way affect the applicability of § 2845, § 2849 or § 2850.

As described in *Moffett v. Miller*, *supra*, 119 Cal. App. 2d at 713-14, while "an absolute and unconditional guaranty" prior to 1939 would not have required the exhaustion by the creditor of his remedies against the principal debtor or other security, after 1939, that same guarantor would have the right to invoke § 2845 of the Civil Code. A guarantor of an unconditional guaranty providing for "immediate liability" may invoke § 2845. *Id.* Plaintiffs only grounds for waiver fail.

Moreover, waiver of the protections provided by California law requires express intent. A guarantor is permitted to waive the rights provided by California law, but such waiver must be express.

A contractual provision that expresses an intent to waive any or all of the rights and defenses described in subdivision (a) shall be effective to waive these rights and defenses without regard to the inclusion of any particular language or phrases in the contract to waive any rights and defenses or any references to statutory provisions or judicial decisions.

Cal. Civ. Code § 2856 (emphasis added). The California Civil Code does not prescribe waiver language. It does offer “safe harbor” language that can be used to unequivocally express waiver. *See* Cal. Civ. Code § 2856(c)(1). Guarantees are interpreted by the same rules used in construing other types of contracts, with a view towards effectuating the purposes for which the contract was designed. *Bloom v. Bender*, 48 Cal. 2d 793, 803, 313 P.2d 568 (1957). The California Supreme Court in *Broom* stated that “carrying out the expressed intent of the parties accords with the basic rules of suretyship law. . . .” *Id.* The guarantees nowhere express an intent to waive the Guarantors’ rights to §§ 2845, 2849, or 2850. To establish knowing waiver, the language of the contract must “adequately express such a waiver.” *River Bank Am. v. Diller*, 38 Cal. App. 4th 1400, 1417 (Cal. App. 1st Dist. 1995). The language in the guarantees is inadequate for that purpose. Express waiver is lacking.

This Court can compare language upon which California courts found express waiver, such as this waiver provision:

Guarantors waive any right to require Lessor to (a) proceed against Lessees; (b) proceed against or exhaust any security held from Lessees; or (c) pursue any other remedy in Lessor's power whatsoever. . . . Until all obligations of Lessees to Lessor shall have been paid in full Guarantors shall have no right of subrogation, and waive any right to enforce any remedy which Lessor now has or may hereafter have against Lessees *and waive any benefit of, and any right to participate in any security now or hereafter held by Lessor.*

American Guaranty Corp. v. Stoodly, *supra*, 230 Cal. App. 2d at 394 (italics added by court). The court found this was adequate to express waiver of the benefit of § 2849. *Cf. WRI Opportunity Loans II, LLC. v. Cooper*, 154 Cal. App. 4th 525, 542 (Cal. App. 2d Dist. 2007) (Finding waiver where contract stated: "Guarantor affirms its intention to waive all benefits that might otherwise be available to Guarantor or Borrower under . . . Civil Code Sections 2809, 2810 . . . , among others.") The language to which Plaintiffs point falls far short of this.

In *Brunswick Corp. v. Hays*, 16 Cal. App. 3d 134, 138 (Cal. App. 2d Dist. 1971), the creditor "proceeded against the principal obligor and the security to the fullest extent possible." The creditor then sought the deficiency from the guarantor. The guarantor asserted § 2809, requiring that "the obligation of a surety cannot be more burdensome than that of

the principal debtor.” *Id.* at 137-38. This required the court to review the interplay of § 2809 with § 2845 and 2849 and the specific recovery made by the creditor. The court held the following sufficient for waiver of the rights of § 2845 and § 2849, relevant for their relationship to § 2809:

This Guaranty is absolute, unconditional and continuing, and payment of the sums for which Guarantor is liable hereunder shall be made . . . *notwithstanding that Brunswick holds reserves, credits, collateral, security or other guarantees against which it may be entitled to resort for payment.*

Id. at 138 (emphasis added). Similar language does not appear in the guarantees at issue. No waiver exists in this case.

Respondents’ case law supports the Guarantors’ position. None of the Respondent’s cited cases establish that the description of a guarantee as “unconditional” or “immediately” payable waives California’s statutory protections. Guarantors addressed *Brunswick* above. *River Bank*, which address a different Code provision (§ 2809), establishes that a specific code section need not be referenced nor must the word “waiver” appear to convey an express intent to waive. *River Bank Am. v. Diller*, 38 Cal App. 4th at 1415-19. These principles are not determinative here.

Bloom also does not affect the outcome of this Court’s inquiry. In *Bloom*, the guarantor objected (among other grounds) that her liability should terminate when the creditor released the principal debtor pursuant

to a composition agreement. *Bloom v. Bender, supra*. The court rejected this argument. *Id.*, 313 P.2d at 572-73. It held that a surety is not discharged by release of the principal where the surety consents to remain liable notwithstanding the release. *Id.* at 572, citing Cal. Civil Code 2819. The court found advance consent to the release of the principal in the guarantee's term that the liability of the guarantor "shall not be affected by . . . the acceptance of any settlement or composition offered by . . . [the principal], either in liquidation, readjustment, receivership, bankruptcy or otherwise." *Id.* at 573. No such consent appears in the case at bar. *Bloom* does not address the same waiver issue, nor does it generally provide support for Plaintiffs' argument that the Guarantors waived protections.

The short, unambiguous guarantees do not express waiver of the protections of California law. No false conflict exists. This Court should reverse and remand the judgments against the Guarantors, directing the application of California law.

C. FAILURE TO JOIN GOTTEX REQUIRES REVERSAL BECAUSE CONSTRUCTION OF THE SUBORDINATION AGREEMENT NECESSARILY AFFECTED GOTTEX AND REQUIRED GOTTEX'S JOINDER

Plaintiffs incorrectly state that the Fourth and Fifth Assignments of Error turn on "Appellants' contention that Freestone's claims were brought in violation of the Subordination Agreement. . . ." *Resp. Brf.*, p.

30. The error turns on the fact that the trial court construed the Subordination Agreement and determined if the claims violated the Subordination Agreement without requiring Gottex's participation. Gottex had an interest in that determination. Gottex should have been made a party *before* the trial court made the determination. Gottex should have been part of a just adjudication of that issue.

Plaintiffs incorrectly characterize the trial court's acknowledgment of Gottex's interest as being an interest "in the Subordination Agreement." *Resp. Brf*, p. 32. They then argue that the trial court found this interest "not affected by the limited relief sought by Freestone...." *Id.* To the contrary, the trial court stated that Gottex has an interest in the action "*through* the subordination agreements." RP 3/13/09 14:13-15 (emphasis added). This interest was not "speculative" or "secondary." No tenable basis supports failure to join Gottex.

Plaintiffs may not have initially sought a declaration about the Subordination Agreement, but when Appellants raised the issue, it necessarily became part of the case. The declaration Plaintiffs sought did "touch" the Subordination Agreement. Construction of the Subordination Agreement concerned Gottex's interests. This Court should reverse and require Gottex's joinder pursuant to CR 19(a) and RCW 7.24.110.

D. THE TRIAL COURT ERRED IN DISMISSING MKA'S BREACH OF CONTRACT CLAIM BECAUSE THIS LAWSUIT IS THE COLLECTION OF A DEBT AND NECESSARILY IMPEDES MKA'S ABILITY TO REPAY GOTTEX

MKA claimed breach of the Subordination Contract. The trial court dismissed this claim when it construed the Subordination Contract and held that Plaintiffs' lawsuit did not breach that contract as a matter of law. If this Court reverses for failure to join Gottex, it should necessarily reinstate this claim because whether the lawsuit breaches the Subordination Agreement will be again at issue.

Plaintiffs do not dispute that this Court must view the summary judgment record favorably to MKA. Plaintiffs assert that this lawsuit is "entirely consistent" with the Subordination Agreement. But, this lawsuit is entirely inconsistent with the Subordination Agreement. This is the fundamental dispute. MKA clarifies that it is not the action against the Guarantors that violates the Subordination Agreement, but the action against MKA. The lawsuit at its very core is an action to collect a debt. The lawsuit distracts MKA and necessarily impedes MKA's ability to repay Gottex. Plaintiffs agreed not to take such action. They have breached their contract.

E. THIS COURT SHOULD REVERSE THE AWARD OF ALL OF THE FEES AND COSTS BECAUSE THE GUARANTORS DID NOT AGREE TO PAY FEES AND COSTS INCURRED PURSUING THE GUARANTEES

No plausible argument supports Plaintiffs recovery of attorney fees incurred in pursuing the Guarantors. Neither the Guarantors nor MKA agreed to be liable for such fees. The documents concern only fees and costs incurred *pursuing MKA*. No document provides for any party's liability for fees incurred pursuing the guarantees. Segregation of fees was required. Plaintiffs do not dispute the segregation requirement if this Court concludes the fees are not authorized. This Court should reverse the fees and costs awarded, and remand for an award of only those fees and costs incurred in pursuing MKA.

Regarding fees on appeal, the fee provisions only concern fees incurred in pursuit of MKA. The majority of this appeal concerns the Guarantors and should not support fees. If the Guarantors prevail on other issues, but lose on that construction of the fee provisions, this Court should award Guarantors fees on appeal.

II. CONCLUSION

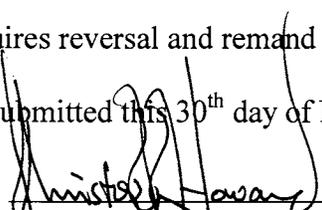
The contacts in this case center on California. This Court should not find personal jurisdiction based only on the fact that the lenders were located in Washington. The trial court's application of Washington law

was error. The trial court erred when it ruled that the Guarantors consented to Washington law. This Court should reverse and remand for further proceedings. If the Court undertakes the conflict of laws analysis, it should conclude that California law applies. The significant contacts with California related to the guarantees should convince this Court that the appropriate substantive law is California's. Application of California law requires a different result in this case. Reversal and remand is appropriate for these reasons.

Reversal and remand is also appropriate for failure to join Gottex. The trial court's construction of the Subordination Agreement necessarily concerned Gottex. That agreement also substantiated MKA's breach of contract claim, which this Court should reinstate.

Finally, the trial court incorrectly awarded attorney fees and costs against the Guarantors when the guarantees and all the documents of record do not provide for them. At a minimum, the fees should have been segregated. This requires reversal and remand of the fee and cost awards.

Respectfully submitted this 30th day of November, 2009.

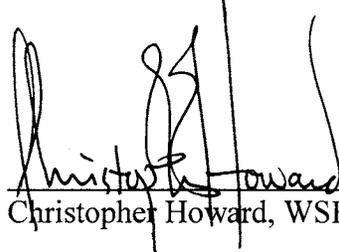


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CERTIFICATE OF SERVICE

I certify and declare that on the 39th day of November, 2009, I caused to be served by first class United States Postal Service the foregoing Reply Brief of Appellants Michael Abraham, Jason Sugarman, and MKA Real Estate Opportunity Fund I, LLC on:

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APPENDIX - 1



LEXSTAT RESTATEMENT CONFLICTS OF LAWS, Å§ 6

Restatement of the Law, Second, Conflict of Laws
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Case Citations

Chapter 1 - Introduction

Restat 2d of Conflict of Laws, § 6

§ 6 Choice-Of-Law Principles

- (1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.**
- (2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include**
 - (a) the needs of the interstate and international systems,**
 - (b) the relevant policies of the forum,**
 - (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,**
 - (d) the protection of justified expectations,**
 - (e) the basic policies underlying the particular field of law,**
 - (f) certainty, predictability and uniformity of result, and**
 - (g) ease in the determination and application of the law to be applied.**

COMMENTS & ILLUSTRATIONS: Comment on Subsection (1):

a. Statutes directed to choice of law. A court, subject to constitutional limitations, must follow the directions of its legislature. The court must apply a local statutory provision directed to choice of law provided that it would be constitutional to do so. An example of a statute directed to choice of law is the Uniform Commercial Code which provides in certain instances for the application of the law chosen by the parties (§ 1-105(1)) and in other instances for the application of the law of a particular state (§§ 2-402, 4-102, 6-102, 8-106, 9-103). Another example is the Model Execution of Wills Act which provides that a written will subscribed by the testator shall be valid as to matters of form if it complies with the local requirements of any one of a number of enumerated states. Statutes that are expressly directed to choice of law, that is to say, statutes which provide for the application of the local law of one state, rather than the local law of another state, are comparatively few in number.

b. Intended range of application of statute. A court will rarely find that a question of choice of law is explicitly

covered by statute. That is to say, a court will rarely be directed by statute to apply the local law of one state, rather than the local law of another state, in the decision of a particular issue. On the other hand, the court will constantly be faced with the question whether the issue before it falls within the intended range of application of a particular statute. The court should give a local statute the range of application intended by the legislature when these intentions can be ascertained and can constitutionally be given effect. If the legislature intended that the statute should be applied to the out-of-state facts involved, the court should so apply it unless constitutional considerations forbid. On the other hand, if the legislature intended that the statute should be applied only to acts taking place within the state, the statute should not be given a wider range of application. Sometimes a statute's intended range of application will be apparent on its face, as when it expressly applies to all citizens of a state including those who are living abroad. When the statute is silent as to its range of application, the intentions of the legislature on the subject can sometimes be ascertained by a process of interpretation and construction. Provided that it is constitutional to do so, the court will apply a local statute in the manner intended by the legislature even when the local law of another state would be applicable under usual choice-of-law principles.

Comment on Subsection (2):

c. Rationale. Legislatures usually legislate, and courts usually adjudicate, only with the local situation in mind. They rarely give thought to the extent to which the laws they enact, and the common law rules they enunciate, should apply to out-of-state facts. When there are no adequate directives in the statute or in the case law, the court will take account of the factors listed in this Subsection in determining the state whose local law will be applied to determine the issue at hand. It is not suggested that this list of factors is exclusive. Undoubtedly, a court will on occasion give consideration to other factors in deciding a question of choice of law. Also it is not suggested that the factors mentioned are listed in the order of their relative importance. Varying weight will be given to a particular factor, or to a group of factors, in different areas of choice of law. So, for example, the policy in favor of effectuating the relevant policies of the state of dominant interest is given predominant weight in the rule that transfers of interests in land are governed by the law that would be applied by the courts of the situs (see §§ 223-243). On the other hand, the policies in favor of protecting the justified expectations of the parties and of effectuating the basic policy underlying the particular field of law come to the fore in the rule that, subject to certain limitations, the parties can choose the law to govern their contract (see § 187) and in the rules which provide, subject to certain limitations, for the application of a law which will uphold the validity of a trust of movables (see §§ 269-270) or the validity of a contract against the charge of commercial usury (see § 203). Similarly, the policy favoring uniformity of result comes to the fore in the rule that succession to interests in movables is governed by the law that would be applied by the courts of the state where the decedent was domiciled at the time of his death (see §§ 260 and 263).

At least some of the factors mentioned in this Subsection will point in different directions in all but the simplest case. Hence any rule of choice of law, like any other common law rule, represents an accommodation of conflicting values. Those chapters in the Restatement of this Subject which are concerned with choice of law state the rules which the courts have evolved in accommodation of the factors listed in this Subsection. In certain areas, as in parts of Property (Chapter 9), such rules are sufficiently precise to permit them to be applied in the decision of a case without explicit reference to the factors which underlie them. In other areas, such as in Wrongs (Chapter 7) and Contracts (Chapter 8), the difficulties and complexities involved have as yet prevented the courts from formulating a precise rule, or series of rules, which provide a satisfactory accommodation of the underlying factors in all of the situations which may arise. All that can presently be done in these areas is to state a general principle, such as application of the local law "of the state of most significant relationship", which provides some clue to the correct approach but does not furnish precise answers. In these areas, the courts must look in each case to the underlying factors themselves in order to arrive at a decision which will best accommodate them.

Statement of precise rules in many areas of choice of law is made even more difficult by the great variety of situations and of issues, by the fact that many of these situations and issues have not been thoroughly explored by the courts, by the generality of statement frequently used by the courts in their opinions, and by the new grounds of decision stated in many of the more recent opinions.

The Comments which follow provide brief discussion of the factors underlying choice of law which are mentioned in this Subsection.

d. Needs of the interstate and international systems. Probably the most important function of choice-of-law rules is to make the interstate and international systems work well. Choice-of-law rules, among other things, should seek to further harmonious relations between states and to facilitate commercial intercourse between them. In formulating rules of choice of law, a state should have regard for the needs and policies of other states and of the community of states. Rules of choice of law formulated with regard for such needs and policies are likely to commend themselves to other states and to be adopted by these states. Adoption of the same choice-of-law rules by many states will further the needs of the interstate and international systems and likewise the values of certainty, predictability and uniformity of result.

e. Relevant policies of the state of the forum. Two situations should be distinguished. One is where the state of the forum has no interest in the case apart from the fact that it is the place of the trial of the action. Here the only relevant policies of the state of the forum will be embodied in its rules relating to trial administration (see Chapter 6). The second situation is where the state of the forum has an interest in the case apart from the fact that it is the place of trial. In this latter situation, relevant policies of the state of the forum may be embodied in rules that do not relate to trial administration.

The problem dealt with in this Comment arises in the common situation where a statute or common law rule of the forum was formulated solely with the intrastate situation in mind or, at least, where there is no evidence to suggest that the statute or rule was intended to have extraterritorial application. If the legislature or court (in the case of a common law rule) did have intentions with respect to the range of application of a statute or common law rule and these intentions can be ascertained, the rule of Subsection (1) is applicable. If not, the court will interpret the statute or rule in the light of the factors stated in Subsection (2).

Every rule of law, whether embodied in a statute or in a common law rule, was designed to achieve one or more purposes. A court should have regard for these purposes in determining whether to apply its own rule or the rule of another state in the decision of a particular issue. If the purposes sought to be achieved by a local statute or common law rule would be furthered by its application to out-of-state facts, this is a weighty reason why such application should be made. On the other hand, the court is under no compulsion to apply the statute or rule to such out-of-state facts since the originating legislature or court had no ascertainable intentions on the subject. The court must decide for itself whether the purposes sought to be achieved by a local statute or rule should be furthered at the expense of the other choice-of-law factors mentioned in this Subsection.

f. Relevant policies of other interested states. In determining a question of choice of law, the forum should give consideration not only to its own relevant policies (see Comment *e*) but also to the relevant policies of all other interested states. The forum should seek to reach a result that will achieve the best possible accommodation of these policies. The forum should also appraise the relative interests of the states involved in the determination of the particular issue. In general, it is fitting that the state whose interests are most deeply affected should have its local law applied. Which is the state of dominant interest may depend upon the issue involved. So if a husband injures his wife in a state other than that of their domicil, it may be that the state of conduct and injury has the dominant interest in determining whether the husband's conduct was tortious or whether the wife was guilty of contributory negligence (see § 146). On the other hand, the state of the spouses' domicil is the state of dominant interest when it comes to the question whether the husband should be held immune from tort liability to his wife (see § 169).

The content of the relevant local law rule of a state may be significant in determining whether this state is the state with the dominant interest. So, for example, application of a state's statute or common law rule which would absolve the defendant from liability could hardly be justified on the basis of this state's interest in the welfare of the injured plaintiff.

g. Protection of justified expectations. This is an important value in all fields of the law, including choice of law.

Generally speaking, it would be unfair and improper to hold a person liable under the local law of one state when he had justifiably molded his conduct to conform to the requirements of another state. Also, it is in part because of this factor that the parties are free within broad limits to choose the law to govern the validity of their contract (see § 187) and that the courts seek to apply a law that will sustain the validity of a trust of movables (see §§ 269-270).

There are occasions, particularly in the area of negligence, when the parties act without giving thought to the legal consequences of their conduct or to the law that may be applied. In such situations, the parties have no justified expectations to protect, and this factor can play no part in the decision of a choice-of-law question.

h. Basic policies underlying particular field of law. This factor is of particular importance in situations where the policies of the interested states are largely the same but where there are nevertheless minor differences between their relevant local law rules. In such instances, there is good reason for the court to apply the local law of that state which will best achieve the basic policy, or policies, underlying the particular field of law involved. This factor explains in large part why the courts seek to apply a law that will sustain the validity of a contract against the charge of commercial usury (§ 203) or the validity of a trust of movables against the charge that it violates the Rule Against Perpetuities (§§ 269-270).

i. Predictability and uniformity of result. These are important values in all areas of the law. To the extent that they are attained in choice of law, forum shopping will be discouraged. These values can, however, be purchased at too great a price. In a rapidly developing area, such as choice of law, it is often more important that good rules be developed than that predictability and uniformity of result should be assured through continued adherence to existing rules. Predictability and uniformity of result are of particular importance in areas where the parties are likely to give advance thought to the legal consequences of their transactions. It is partly on account of these factors that the parties are permitted within broad limits to choose the law that will determine the validity and effect of their contract (see § 187) and that the law that would be applied by the courts of the state of the situs is applied to determine the validity of transfers of interests in land (see § 223). Uniformity of result is also important when the transfer of an aggregate of movables, situated in two or more states, is involved. Partly for this reason, the law that would be applied by the courts of the state of a decedent's domicile at death is applied to determine the validity of his will in so far as it concerns movables (see § 263) and the distribution of his movables in the event of intestacy (see § 260).

j. Ease in the determination and application of the law to be applied. Ideally, choice-of-law rules should be simple and easy to apply. This policy should not be overemphasized, since it is obviously of greater importance that choice-of-law rules lead to desirable results. The policy does, however, provide a goal for which to strive.

k. Reciprocity. In formulating common law rules of choice of law, the courts are rarely guided by considerations of reciprocity. Private parties, it is felt, should not be made to suffer for the fact that the courts of the state from which they come give insufficient consideration to the interests of the state of the forum. It is also felt that satisfactory development of choice-of-law rules can best be attained if each court gives fair consideration to the interests of other states without regard to the question whether the courts of one or more of these other states would do the same. As to whether reciprocity is a condition to the recognition and enforcement of a judgment of a foreign nation, see § 98, Comment *e*.

States sometimes incorporate a principle of reciprocity into statutes and treaties. They may do so in order to induce other states to take certain action favorable to their interests or to the interests of their citizens. So, as stated in § 89, Comment *b*, many States of the United States have enacted statutes which provide that a suit by a sister State for the recovery of taxes will be entertained in the local courts if the courts of the sister State would entertain a similar suit by the State of the forum. Similarly, by way of further example, some States of the United States provide by statute that an alien cannot inherit local assets unless their citizens in turn would be permitted to inherit in the state of the alien's nationality. A principle of reciprocity is also sometimes employed in statutes to permit reciprocating states to obtain by cooperative efforts what a single state could not obtain through the force of its own law. See, e. g., Uniform Reciprocal Enforcement of Support Act; Uniform (Reciprocal) Act to Secure Attendance of Witnesses from Without a State in

Criminal Proceedings; Interpleader Compact Law.

REPORTERS NOTES: The rule of this Section was cited and applied in *Mitchell v. Craft*, 211 So.2d 509 (Miss.1968). Subsection (1) of the rule was cited and applied in *Oxford Consumer Discount Company v. Stefanelli*, 102 N.J.Super. 549, 246 A.2d 460 (1968).

See generally Leflar, Choice-Influencing Considerations in Conflicts Law, 41 N.Y.U.L.Rev. 267 (1966); Leflar, Conflicts Law: More on Choice-Influencing Considerations, 54 Calif.L.Rev. 1584 (1966); Traynor, Is This Conflict Really Necessary? 37 Texas L.Rev. 657 (1954); Cheatham and Reese, Choice of the Applicable Law, 52 Colum.L.Rev. 959 (1952); Reese, Conflict of Laws and the Restatement Second, 28 Law & Contemp. Prob. 679 (1963).

Cases where the court explicitly looked to similar factors in deciding a question of choice of law are *Clark v. Clark*, 107 N.H. 351, 222 A.2d 205 (1966); *Heath v. Zellmer*, 35 Wis.2d 578, 151 N.W.2d 664 (1967).

Comment k: On the subject of reciprocity, see Lenhoff, Reciprocity and the Law of Foreign Judgments, 16 La.L.Rev. 465 (1956); Lenhoff, Reciprocity in Function, 15 U. Pitt.L.Rev. 44 (1954); Lenhoff, Reciprocity: The Legal Aspect of a Perennial Idea, 44 Nw.U.L.Rev. 619, 662 (1952).

On rare occasions, the courts have incorporated the reciprocity principle into a common law rule of choice of law. See e. g., *Forgan v. Bainbridge*, 34 Ariz. 408, 274 Pac. 155 (1928); *Union Securities Co. v. Adams*, 33 Wyo. 45 236 Pac. 513 (1925).

CROSS REFERENCES: ALR Annotations:

Duty of courts to follow decisions of other states, on questions of common law or unwritten law, in which the cause of action had its situs. 73 A.L.R. 897.

Digest System Key Numbers:

Action 17

Legal Topics:

For related research and practice materials, see the following legal topics:
Civil Procedure Federal & State Interrelationships General Overview

APPENDIX - 2



LEXSTAT RESTAT 2D OF CONFLICT OF LAWS SECTION 188

Restatement of the Law, Second, Conflict of Laws
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Case Citations

Chapter 8 - Contracts

Topic 1 - Validity of Contracts and Rights Created Thereby

Title A - General Principles

Restat 2d of Conflict of Laws, § 188

§ 188 Law Governing in Absence of Effective Choice by the Parties

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,**
- (b) the place of negotiation of the contract,**
- (c) the place of performance,**
- (d) the location of the subject matter of the contract, and**
- (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.**

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

COMMENTS & ILLUSTRATIONS: Comment:

a. Scope of section. The rule of this Section applies in all situations where there has not been an effective choice of the applicable law by the parties (see § 187).

Comment on Subsection (1):

b. Rationale. The principles stated in § 6 underlie all rules of choice of law and are used in evaluating the significance of a relationship, with respect to the particular issue, to the potentially interested states, the transaction and the parties. The factors listed in Subsection (2) of the rule of § 6 can be divided into five groups. One group is concerned with the fact that in multistate cases it is essential that the rules of decision promote mutually harmonious and beneficial relationships in the interdependent community, federal or international. The second group focuses upon the purposes, policies, aims and objectives of each of the competing local law rules urged to govern and upon the concern of the potentially interested states in having their rules applied. The factors in this second group are at times referred to as "state interests" or as appertaining to an "interested state." The third group involves the needs of the parties, namely the protection of their justified expectations and certainty and predictability of result. The fourth group is directed to implementation of the basic policy underlying the particular field of law, such as torts or contracts, and the fifth group is concerned with the needs of judicial administration, namely with ease in the determination and application of the law to be applied.

The factors listed in Subsection (2) of the rule of § 6 vary somewhat in importance from field to field and from issue to issue. Thus, the protection of the justified expectations of the parties is of considerable importance in contracts whereas it is of relatively little importance in torts (see § 145, Comment *b*). In the torts area, it is the rare case where the parties give advance thought to the law that may be applied to determine the legal consequences of their actions. On the other hand, parties enter into contracts with forethought and are likely to consult a lawyer before doing so. Sometimes, they will intend that their rights and obligations under the contract should be determined by the local law of a particular state. In this event, the local law of this state will be applied, subject to the qualifications stated in the rule of § 187. In situations where the parties did not give advance thought to the question of which should be the state of the applicable law, or where their intentions in this regard cannot be ascertained, it may at least be said, subject perhaps to rare exceptions, that they expected that the provisions of the contract would be binding upon them.

The need for protecting the expectations of the parties gives importance in turn to the values of certainty, predictability and uniformity of result. For unless these values are attained, the expectations of the parties are likely to be disappointed.

Protection of the justified expectations of the parties by choice-of-law rules in the field of contracts is supported both by those factors in Subsection (2) of § 6 which are directed to the furtherance of the needs of the parties and by those factors which are directed to implementation of the basic policy underlying the particular field of law. Protection of the justified expectations of the parties is the basic policy underlying the field of contracts.

Protection of the justified expectations of the parties is a factor which varies somewhat in importance from issue to issue. As indicated above, this factor is of considerable importance with respect to issues involving the validity of a contract, such as capacity, formalities and substantial validity. Parties entering a contract will expect at the very least, subject perhaps to rare exceptions, that the provisions of the contract will be binding upon them. Their expectations should not be disappointed by application of the local law rule of a state which would strike down the contract or a provision thereof unless the value of protecting the expectations of the parties is substantially outweighed in the particular case by the interest of the state with the invalidating rule in having this rule applied. The extent of the interest of a state in having its rule applied should be determined in the light of the purpose sought to be achieved by the rule and by the relation of the transaction and the parties to that state (see Comment *c*).

Protection of justified expectations plays a less significant role in the choice-of-law process with respect to issues that involve the nature of the obligations imposed by a contract upon the parties rather than the validity of the contract or of some provision thereof. By and large, it is for the parties themselves to determine the nature of their contractual obligations. They can spell out these obligations in the contract or, as a short-hand device, they can provide that these obligations shall be determined by the local law of a given state (see § 187, Comment *c*). If the parties do neither of these two things with respect to an issue involving the nature of their obligations, as, for example, the time of

performance, the resulting gap in their contract must be filled by application of the relevant rule of contract law of a particular state. All states have gap-filling rules of this sort, and indeed such rules comprise the major content of contract law. What is important for present purposes is that a gap in a contract usually results from the fact that the parties never gave thought to the issue involved. In such a situation, the expectations of the parties with respect to that issue are unlikely to be disappointed by application of the gap-filling rule of one state rather than of the rule of another state. Hence with respect to issues of this sort, protection of the justified expectations of the parties is unlikely to play so significant a role in the choice-of-law process. As a result, greater emphasis in fashioning choice-of-law rules in this area must be given to the other choice-of-law principles mentioned in the rule of § 6.

c. Purpose of contract rule. The purpose sought to be achieved by the contract rules of the potentially interested states, and the relation of these states to the transaction and the parties, are important factors to be considered in determining the state of most significant relationship. This is because the interest of a state in having its contract rule applied in the determination of a particular issue will depend upon the purpose sought to be achieved by that rule and upon the relation of the state to the transaction and the parties. So the state where a party to the contract is domiciled has an obvious interest in the application of its contract rule designed to protect that party against the unfair use of superior bargaining power. And a state where a contract provides that a given business practice is to be pursued has an obvious interest in the application of its rule designed to regulate or to deter that business practice. On the other hand, the purpose of a rule and the relation of a state to the transaction and the parties may indicate that the state has little or no interest in the application of that rule in the particular case. So a state may have little interest in the application of a rule designed to protect a party against the unfair use of superior bargaining power if the contract is to be performed in another state which is the domicile of the person seeking the rule's protection. And a state may have little interest in the application of a statute designed to regulate or to deter a certain business practice if the conduct complained of is to take place in another state.

Whether an invalidating rule should be applied will depend, among other things, upon whether the interest of the state in having its rule applied to strike down the contract outweighs in the particular case the value of protecting the justified expectations of the parties and upon whether some other state has a greater interest in the application of its own rule.

Frequently, it will be possible to decide a question of choice of law in contract without paying deliberate attention to the purpose sought to be achieved by the relevant contract rules of the interested states. This will be so whenever by reason of the particular circumstances one state is obviously that of the applicable law.

d. The issue involved. The courts have long recognized that they are not bound to decide all issues under the local law of a single state. Thus, in an action on a contract made and to be performed in a foreign state by parties domiciled there, a court under traditional and prevailing practice applies its own state's rules to issues involving process, pleadings, joinder of parties, and the administration of the trial (see Chapter 6), while deciding other issues -- such as whether the defendant had capacity to bind himself by contract -- by reference to the law selected by application of the rules stated in this Chapter. The rule of this Section makes explicit that selective approach to choice of the law governing particular issues.

Each issue is to receive separate consideration if it is one which would be resolved differently under the local law rule of two or more of the potentially interested states.

Comment on Subsection (2):

e. Important contacts in determining state of most significant relationship. In the absence of an effective choice of law by the parties (see § 187), the forum, in applying the principles of § 6 to determine the state of most significant relationship, should give consideration to the relevant policies of all potentially interested states and the relative interests of those states in the decision of the particular issue. The states which are most likely to be interested are those which have one or more of the following contacts with the transaction or the parties. Some of these contacts also figure

prominently in the formulation of the applicable rules of choice of law.

The place of contracting. As used in the Restatement of this Subject, the place of contracting is the place where occurred the last act necessary, under the forum's rules of offer and acceptance, to give the contract binding effect, assuming, hypothetically, that the local law of the state where the act occurred rendered the contract binding.

Standing alone, the place of contracting is a relatively insignificant contact. To be sure, in the absence of an effective choice of law by the parties, issues involving the validity of a contract will, in perhaps the majority of situations, be determined in accordance with the local law of the state of contracting. In such situations, however, this state will be the state of the applicable law for reasons additional to the fact that it happens to be the place where occurred the last act necessary to give the contract binding effect. The place of contracting, in other words, rarely stands alone and, almost invariably, is but one of several contacts in the state. Usually, this state will be the state where the parties conducted the negotiations which preceded the making of the contract. Likewise, this state will often be the state of the parties' common domicile as well. By way of contrast, the place of contracting will have little significance, if any, when it is purely fortuitous and bears no relation to the parties and the contract, such as when a letter of acceptance is mailed in a railroad station in the course of an interstate trip.

The place of negotiation. The place where the parties negotiate and agree on the terms of their contract is a significant contact. Such a state has an obvious interest in the conduct of the negotiations and in the agreement reached. This contact is of less importance when there is no one single place of negotiation and agreement, as, for example, when the parties do not meet but rather conduct their negotiations from separate states by mail or telephone.

The place of performance. The state where performance is to occur under a contract has an obvious interest in the nature of the performance and in the party who is to perform. So the state where performance is to occur has an obvious interest in the question whether this performance would be illegal (see § 202). When both parties are to perform in the state, this state will have so close a relationship to the transaction and the parties that it will often be the state of the applicable law even with respect to issues that do not relate strictly to performance. And this is even more likely to be so if, in addition, both parties are domiciled in the state.

On the other hand, the place of performance can bear little weight in the choice of the applicable law when (1) at the time of contracting it is either uncertain or unknown, or when (2) performance by a party is to be divided more or less equally among two or more states with different local law rules on the particular issue.

It is clear that the local law of the place of performance will be applied to govern all questions relating to details of performance (see § 206).

Situs of the subject matter of the contract. When the contract deals with a specific physical thing, such as land or a chattel, or affords protection against a localized risk, such as the dishonesty of an employee in a fixed place of employment, the location of the thing or of the risk is significant (see §§ 189-193). The state where the thing or the risk is located will have a natural interest in transactions affecting it. Also the parties will regard the location of the thing or of the risk as important. Indeed, when the thing or the risk is the principal subject of the contract, it can often be assumed that the parties, to the extent that they thought about the matter at all, would expect that the local law of the state where the thing or risk was located would be applied to determine many of the issues arising under the contract.

Domicil, residence, nationality, place of incorporation, and place of business of the parties. These are all places of enduring relationship to the parties. Their significance depends largely upon the issue involved and upon the extent to which they are grouped with other contacts. So, for example, when a person has capacity to bind himself to the particular contract under the local law of the state of his domicile, there may be little reason to strike down the contract because that person lacked capacity under the local law of the state of contracting or of performance (see § 198). The fact that one of the parties is domiciled or does business in a particular state assumes greater importance when combined with other contacts, such as that this state is the place of contracting or of performance or the place where the

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other party to the contract is domiciled or does business. As stated in § 192, the domicil of the insured is a contact of particular importance in the case of life insurance contracts. At least with respect to most issues, a corporation's principal place of business is a more important contact than the place of incorporation, and this is particularly true in situations where the corporation does little, or no, business in the latter state.

Illustrations: 1. A, who is domiciled in state X, is declared a spendthrift by an X court. Thereafter, A borrows money in state Y from B, a Y domiciliary; who lends the money in ignorance of A's spendthrift status. Under the terms of the loan, the money is to be repaid in Y. A does not pay, and B brings suit in state Z. A would not be liable under X local law because he has been declared a spendthrift; he would, however, be liable under the local law of Y. The first question for the Z court to determine is whether the interests of both X and Y would be furthered by application of their respective local law rules. This is a question that can only be determined in the light of the respective purposes of these rules (see Comment c). The purpose of the X local law rule is obviously to protect X domiciliaries and their families. Hence the interests of X would be furthered by application of the X spendthrift rule. On the other hand, Y's interests would be furthered by the application of its own rule, which presumably was intended for the protection of Y creditors and also to encourage persons to enter into contractual relationships in Y. Since the interests of X and Y would each be furthered by application of their respective rules, the Z court must choose between them. Among the questions for the Z court to determine are whether the value of protecting the justified expectations of the parties and the interest of Y in the application of its rule outweigh X's interest in the application of its invalidating rule. Factors which would support an affirmative answer to this question, and which indicate the degree of Y's interest in the application of its rule, are that A sought out B in Y, that B is domiciled in Y, that the loan was negotiated and made in Y and that the contract called for repayment in Y (see § 195). If it is found that an X court would not have applied its rule to the facts of the present case, the argument for applying the Y rule would be even stronger. For it would then appear that, even in the eyes of the X court, X interests were not sufficiently involved to require application of the X rule (see § 8, Comment k).

2. A, a married woman, who is domiciled in state X, comes to state Y and there borrows money from B. The loan contract provides that the money is to be repaid in Y. A does not pay, and B brings suit in state Z. A defends on the ground that under Y local law married women lack capacity to bind themselves by contract; they do have such capacity, however, under the local law of X. It is questionable in this case whether the interests of either X or Y would be furthered by application of their respective rules. Y's rule of incapacity was presumably designed to protect Y married women. On the other hand, X's rule of capacity was presumably designed, at least primarily, to protect X transactions. It seems clear in any event that the value of protecting the justified expectations of the parties is not outweighed in this case by any interest Y may have in the application of its rule of incapacity. Under the circumstances, the contract should be upheld on the issue of A's capacity by application of the X rule.

Comment on Subsection (3):

f. When place of negotiation and place of performance are in the same state. When the place of negotiation and the place of performance are in the same state, the local law of this state will usually be applied to govern issues arising under the contract, except as stated in §§ 189-199 and 203. A state having these contacts will usually be the state that has the greatest interest in the determination of issues arising under the contract. The local law of this state should be applied except when the principles stated in § 6 require application of some other law. As stated in Comment c, the extent of a state's interest in having its contract rule applied will depend upon the purpose sought to be achieved by that rule.

g. For reasons stated in § 186, Comment b, the reference is to the "local law" of the state of the applicable law and not to that state's "law" which means the totality of its law including its choice-of-law rules.

h. As to the situation where the local law rule of two or more states is the same, see § 186, Comment c.

REPORTERS NOTES: See *Rungee v. Allied Van Lines, Inc.*, 92 Idaho 718, 449 P.2d 378 (1968) (quoting and applying rule of Section).

See generally *Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 161-162 (1946) (a case involving the validity of a covenant contained in a mortgage indenture where the Court said: "In determining which contract is the most significant in a particular transaction, courts can seldom find a complete solution in the mechanical formulae of the conflicts of law. Determination requires the exercise of an informed judgment in the balancing of all the interests of the states with the most significant contacts in order best to accommodate the equities among the parties to the policies of those states."); *Rutas Aereas Nacionales, S. A. v. Robinson*, 339 F.2d 265 (5th Cir. 1964); *Whitman v. Green*, 289 F.2d 566 (9th Cir. 1961) (note executed in Idaho by Idaho resident and secured by Idaho realty upheld against charge of usury by application of local law of Washington where note was delivered and payable. "In the case at bar the lender did not seek out the borrower in the State of Idaho, nor sit in wait for him in that state. Rather, the borrower sought out the lender in the State of Washington."); *Perrin v. Pearlstein*, 314 F.2d 863 (2d Cir. 1963); *Teas v. Kimball*, 257 F.2d 817, 824 (5th Cir. 1958) ("... the focus of the contract was so centered in Texas that its validity should be determined by the laws of contract of that state"); *Global Commerce Corp. v. Clark-Babbitt Industries*, 239 F.2d 716 (2d Cir. 1956); *Alaska Airlines, Inc. v. Stephenson*, 217 F.2d 295 (9th Cir. 1954); *Grace v. Livingstone*, 195 F.Supp. 933, 935 (D.Mass.1961), aff'd per curiam 297 F.2d 836 (1962), cert. den. sub. nom. 369 U.S. 871 (1962) ("In the silence of the parties, Massachusetts law governs for reasons well explained in the notes accompanying the April 22, 1960, amendments to the Second Restatement of Conflict of Laws, Tentative Draft No. 6."); *Metzenbaum v. Golwynne Chemicals Corp.*, 159 F.Supp. 648 (S.D.N.Y.1958); *Mutual Life Ins. Co. v. Simon*, 151 F.Supp. 408 (S.D.N.Y.1957); *Fricke v. Isbrandtsen Co., Inc.*, 151 F.Supp. 465, 467 (S.D.N.Y.1957) ("Ordinarily the federal courts determine which law governs a contract by 'grouping of contacts' or 'finding the center of gravity' of the contract. The law of the jurisdiction having the closest relation to the contract is selected because, it is felt, the parties contracted probably with that law (if any law) in mind, and that jurisdiction would probably have the greatest interest in defining the rights of the contracting parties. This doctrine, however nebulous in its statement, seems to fulfill more adequately the expectations of the parties than the definitively worded, but often artificially applied, doctrine of *lex loci contractus*"); *Mulvihill v. Furness, Withy & Co.*, 136 F.Supp. 201, 206 (S.D.N.Y.1955) ("... the most salutary resolution of the conflicts problem is to ascertain the forum having the closest connection with the matters raised by the litigation."); *Bernkrant v. Fowler*, 55 Cal.2d 588, 360 P.2d 906 (1961) (application of Nevada local law to uphold an oral contract to make a will which would be invalid under the statute of frauds of California, the state of the decedent's domicil, based upon the interests of the two states, protection of the justified expectations of the parties, and the relevant contacts); *Cochran v. Ellsworth*, 126 Cal.App.2d 429, 437, 272 P.2d 904, 909 (1954) ("In this situation the bare physical act of signing the written instrument was a fortuitous, fleeting and relatively insignificant circumstance in the total contractual relationship between the parties. It should not be elevated to paramount importance, particularly when to do so will serve only the purpose of rendering invalid an otherwise legal agreement."); *Graham v. Wilkins*, 145 Conn. 34, 138 A.2d 705 (1958) (contract made in Pennsylvania to be performed in various states held governed by Connecticut local law on the ground that it had its "beneficial operation and effect" in Connecticut); *Gregg v. Fitzpatrick*, 54 Ga.App. 303, 187 S.E. 730 (1936) (contacts enumerated and local law of state in which majority of contacts were grouped applied); *W. H. Barber Co. v. Hughes*, 223 Ind. 570, 586, 63 N.E.2d 417, 423 (1945) ("The court will consider all acts of the parties touching the transaction in relation to the several states involved and will apply as the law governing the transaction the law of that state with which the facts are in most intimate contact."); *H I M C Investment Co. v. Sicialiano*, 103 N.J.Super. 27, 246 A.2d 502 (1968); *Spahr v. P. & H. Supply Co.*, 223 Ind. 591, 63 N.E.2d 425 (1945); *Auten v. Auten*, 308 N.Y. 155, 161, 124 N.E.2d 99, 102 (1954) ("Although this 'grouping of contacts' theory may, perhaps, afford less certainty and predictability than the rigid general rules... the merit of its approach is that it gives to the place 'having the most interest in the problem' paramount control over the legal issues arising out of a particular factual context, thus allowing the forum to apply the policy of the jurisdiction 'most intimately concerned with the outcome of [the] particular litigation'... Moreover, by stressing the significant contacts, it enables the court not only to reflect the relative interests of the several jurisdictions involved... but also to give effect to the probable intention of the parties and consideration to 'whether one rule or the other produces the best practical result.'"); *Rubin v. Irving Trust Co.*, 305 N.Y. 288, 113 N.E.2d 424 (1953); *Lilienthal v. Kaufman*, 239 Or. 1, 395 P.2d 543 (1964); *Johnston v. Commercial Travelers Mut. Acc. Ass'n*, 242 S.C. 387, 131 S.E.2d 91 (1963); *Boston Law Book Co. v. Hathorn*, 119 Vt. 416, 423, 127 A.2d 120, 125 (1956) ("... where the contract contains no explicit provision that it is to be governed by some particular law the courts 'examine all the points of contact which the transaction has with the two or more jurisdictions involved, with the

view to determine the "center of gravity" of the contract, or of that aspect of the contract immediately before the court, and when they have identified the jurisdiction with which the matter at hand is predominantly or most intimately concerned, they conclude that this is the proper law of the contract which the parties presumably had in view at the time of contracting.""); *Peterson v. Warren*, 31 Wis.2d 547, 143 N.W.2d 560 (1966) (citing §§ 332 and 346 of Tent.Draft No. 6, 1960 and § 599d of Tent.Draft No. 11, 1965); *Wojciuk v. United States Rubber Co.*, 19 Wis.2d 224, 122 N.W.2d 737 (1963) (rights of parties for breach of warranty will be determined by the law of the place "most closely associated with the transaction"); *Potlatch No. 1 Federal Credit Union v. Kennedy*, Wash.2d , 459 P.2d 32 (1969) (quoting and applying rule of Section); *Baffin Land Corp. v. Monticello Motor Inn, Inc.*, 70 Wash.2d 893, 425 P.2d 623 (1967) (quoting and applying rule as stated in § 332 of Tent.Draft No. 6, 1960); *In re Estate of Knippel*, 7 Wis.2d 335, 96 N.W.2d 514 (1959).

Comment b: The importance of protecting the justified expectations of the parties in contract choice-of-law cases has been frequently emphasized. See, e. g., *Kossick v. United Fruit Co.*, 365 U.S. 731, 741 (1961) ("... we are dealing here with a contract, and therefore with obligations, by hypothesis, voluntarily undertaken. . . . This fact in itself creates some presumption in favor of applying the law tending toward the validation of the alleged contract."); *Pritchard v. Norton*, 106 U.S. 124 (1882); *Teas v. Kimball*, 257 F.2d 817 (5th Cir. 1958); *Heede, Inc. v. West India Machinery and Supply Co.*, 272 F.Supp. 236 (S.D.N.Y.1967); *Bernkrant v. Fowler*, *supra*; Ehrenzweig, *Contracts in the Conflict of Laws*, 59 *Colum.L.Rev.* 973, 1171 (1959). This policy is of little assistance in situations where the question is whether an individual provision of a contract should be invalidated in order to preserve the principal obligation. See, e. g., *Zogg v. Penn Mutual Life Insurance Co.*, 276 F.2d 861 (2d Cir. 1960); *Auten v. Auten*, *supra*.

The desire of the courts to uphold contracts is demonstrated by the usury cases cited in the Reporter's Note to § 203.

The Uniform Commercial Code provides in § 1-105 that, in the absence of an effective choice of law by the parties, its provisions are applicable to "transactions bearing an appropriate relation to this state."

For a suggestion that where the parties are to perform in different states the obligations of each party under the contract will be determined, at least on occasion, by the local law of the state where he was to perform, see *Auten v. Auten*, *supra*.

For a suggested alternative formulation, see Weintraub, *Choice of Law in Contract*, 54 *Iowa L.Rev.* 399 (1968).

CROSS REFERENCES: ALR Annotations:

Validity and effect of stipulation in contract to the effect that it shall be governed by the law of a particular state which is neither the place where the contract is made nor the place where it is to be performed. 112 *A.L.R.* 124.

Digest System Key Numbers:

Contracts 2, 101, 144, 276, 325

Legal Topics:

For related research and practice materials, see the following legal topics:

Civil Procedure Federal & State Interrelationships Choice of Law Significant Relationships

APPENDIX - 3



LEXSTAT RESTAT 2D OF CONFLICT OF LAWS, Â§ 194

Restatement of the Law, Second, Conflict of Laws
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Case Citations

Chapter 8 - Contracts

Topic 1 - Validity of Contracts and Rights Created Thereby

Title B - Particular Contracts

Restat 2d of Conflict of Laws, § 194

§ 194 Contracts of Suretyship

The validity of a contract of suretyship and the rights created thereby are determined, in the absence of an effective choice of law by the parties, by the law governing the principal obligation which the contract of suretyship was intended to secure, unless, with respect to the particular issue, some other state has a more significant relationship under the principles stated in § 6 to the transaction and the parties, in which event the local law of the other state will be applied.

COMMENTS & ILLUSTRATIONS: Comment:

a. Scope of section and meaning of terms. The rule of this Section applies to all contracts in which one person, "the surety," promises a second person, "the creditor," to perform the obligation, or to answer for the default, of a third person, "the debtor." The obligation of the surety to the creditor may be primary in the sense that he is as much bound as the debtor to perform the latter's undertaking. On the other hand, the surety's obligation may be only secondary and depend for its existence upon the debtor being in default.

"Suretyship" is the relation which exists when one person has undertaken an obligation and another person is also under an obligation or other duty to the obligee, who is entitled to but one performance, and, as between the two who are bound, one rather than the other should perform (see *Restatement of Security* § 82). "Suretyship," as here used, includes "guaranty," for, as stated in § 82, Comment g, of the *Restatement of Security*, there has never been general agreement as to what distinction, if any, should be drawn between the two terms.

The law determined by application of the rule of this Section determines such issues as whether the surety can be held liable under his contract despite the invalidity of the principal obligation, whether the suretyship contract is invalid for lack of capacity on the part of the surety, whether the creditor can proceed directly against the surety without having first attempted to enforce the contract against the principal, and whether the surety can defend successfully on the ground that the creditor has not proceeded with due diligence against the principal or has failed to give the surety notice of the principal's default. The same law determines the efficacy of such defenses by the surety as impossibility or illegality of performance by the principal, fraud or duress practiced on the principal by the creditor or on the surety by the principal, the principal's lack of capacity, failure of consideration between creditor and principal, and the creditor's

release of the principal or modification by the creditor of the principal's duty (see *Restatement of Security*, §§ 114-143).

b. Rationale. It is possible for the surety's obligation to the creditor to be governed by a different law from that which governs the obligation of the principal debtor. This is particularly likely to be so when the surety and creditor have actually chosen the state whose local law they wish to have govern the validity of their contract and the rights created thereby. The chosen law will so be applied by the courts under the circumstances stated in § 187, even though another law governs the principal obligation.

In the absence of an effective choice of law by the parties, the validity of the suretyship contract and the rights created thereby will usually be determined by the law which governs the principal obligation. In the nature of things, the two contracts will usually be closely related and have many common elements. Particularly when the two contracts are contained in the same instrument or when both were made at around the same time, application of ordinary choice-of-law rules (see § 188) will frequently lead to a decision that both contracts are governed by the same law. Such a conclusion is likewise dictated by considerations of practicality and convenience. In addition, the contract of suretyship can often be considered accessory, or subsidiary, to the principal obligation. In situations where there are several sureties and several contracts of suretyship, the convenience of having all these contracts determined by the law which governs the principal obligation becomes even more apparent.

c. When law governing principal obligation will not be applied. On occasion, a state which is not the state whose local law governs the principal obligation will nevertheless, with respect to the particular issue, be the state of most significant relationship to the suretyship contract and the parties and hence the state of the applicable law. This may be so, for example, when the contract would be invalid under the law governing the principal obligation but valid under the local law of another state with a close relation to the transaction and the parties. This may also be so when the suretyship agreement bears little or no relation to the state whose local law governs the principal obligation. A sufficient relationship to justify application of the law governing the principal obligation would, however, exist if the state whose local law governs the obligation was (1) the state where the creditor extended credit to the principal or otherwise relied upon the surety's promise, unless the surety had not authorized the principal to seek credit or other performance in that state and the creditor had reason to know of this lack of authority, or (2) the state where the contract of suretyship was to be performed, or (3) the state where the negotiations between the surety and creditor were conducted or where the surety delivered the contract to the creditor, or (4) the state of domicile of either the creditor or the surety. Presumably, there are still other relationships which will suffice.

d. For reasons stated in § 187, Comment *b*, the reference is to the "local law" of the state of the applicable law and not to that state's "law," which means the totality of its law including its choice-of-law rules.

e. As to the situation where the relevant local law rule of two or more states is the same, see § 187, Comment *c*. Particular issues are discussed in Title C (§§ 198-207).

REPORTERS NOTES: The significance of the parties' choice has been emphasized by some courts. *Aluminum Co. of America v. Hully*, 200 F.2d 257 (8th Cir. 1952); *Nissenberg v. Felleman*, 339 Mass. 717, 162 N.E.2d 304 (1959); see *T. R. Watkins Co. v. Hill*, 214 Ala. 507, 108 So. 244 (1926); *County Savings Bank v. Jacobson*, 202 Iowa 1263, 211 N.W. 864 (1927).

In the absence of a choice-of-law clause, some courts have given explicit weight to the law governing the principal obligation in determining the law governing the suretyship contract. See e. g., *American State Bank v. United States Fidelity & Guaranty Co.*, 331 F.2d 479 (7th Cir. 1964); *Socony-Vacuum Oil Co. v. Continental Casualty Co.*, 219 F.2d 645 (2d Cir. 1955); *Bond v. John V. Farwell Co.*, 172 Fed. 58 (6th Cir. 1909); *Richter v. Frank*, 41 Fed. 859 (C.C.N.D.Ill. 1890), error dismissed; 154 U.S. 503 (1893); *Philip Carey Co. v. Maryland Casualty Co.*, 201 Iowa 1063, 206 N.W. 808 (1926); *Chemical Nat. Bank v. Kellogg*, 183 N.Y. 92, 75 N.E. 1103 (1905); *Pugh v. Cameron's Administrator*, 11 W.Va. 523 (1877); *Rouquette v. Overman*, (1875) L.R. 10 Q.B. 525; cf. *National Surety Co. v. Nazzaro*, 239 Mass. 341, 132 N.E. 49 (1921).

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In the majority of cases, however, the courts have stated that the law governing the suretyship contract is the local law of the state where the creditor acted upon the guaranty by extending credit. See, e. g., *Ladd & Bush v. Hayes*, 105 F.2d 292 (9th Cir. 1939); *Milliken v. Pratt*, 125 Mass. 374 (1878); *John A. Tolman Co. v. Reed*, 115 Mich. 71, 72 N.W. 1104 (1897); *State of Ohio v. Purse*, 273 Mich. 507, 263 N.W. 874 (1935); *Irving National Bank v. Ellis*, 74 N.J.L. 42, 64 Atl. 1071 (1906). In all of these cases the state whose local law was applied was the state whose local law governed the principal obligation and which had a substantial relationship to the suretyship contract. There are a few cases in which the application of the local law of the state where the creditor extended credit would have resulted in the suretyship contract being governed by a law different from the one governing the principal obligation. In most cases of this sort, the courts have applied the law governing the principal obligation. *Fisk Rubber Co. v. Muller*, 42 App.D.C. 49 (1914); *Basilea v. Spagnuolo*, 80 N.J.L. 88, 77 Atl. 531 (1910).

For a case where the same law was held to govern both the suretyship contract and the principal contract although the suretyship contract was made later in point of time, see *Pugh v. Cameron's Administrator*, *supra*; cf. *Pritchard v. Norton*, 106 U.S. 124 (1882). Cases where the same law was held to govern both the suretyship contract and the principal contract, although the suretyship contract was made earlier in point of time, include *Milliken v. Pratt*, *supra*; *Bond v. John V. Farwell Co.*, *supra*.

See generally Battifol, *Les Conflits de Lois en Matiere de Contrats* 424-425 (1938); 3 Rabel, *Conflict of Laws* 344-360 (1950).

CROSS REFERENCES: ALR Annotations:

Conflict of laws as to disposition of and relative rights to bank deposits in the names of more than one person. 25 *A.L.R.2d* 1240.

Conflict of laws regarding deficiency in respect of debt secured by mortgage or deed of trust. 136 *A.L.R.* 1057.

Digest System Key Numbers:

Principal and Surety 2, 60

Legal Topics:

For related research and practice materials, see the following legal topics:

Civil Procedure Federal & State Interrelationships Choice of Law Significant Relationships Contracts Law Types of Contracts Guaranty Contracts



LEXSTAT CAL CIV CODE Â§ 2807

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EFF. MAY 20, 2009

CIVIL CODE
Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 13. Suretyship
Article 4. Liability of Sureties

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Cal Civ Code § 2807 (2009)

§ 2807. Necessity for demand or notice; Surety for payment or performance

A surety who has assumed liability for payment or performance is liable to the creditor immediately upon the default of the principal, and without demand or notice.

HISTORY:

Enacted 1872. Amended Stats 1939 ch 453 § 18.

NOTES:

Amendments:

1939 Amendment:

Substituted (1) "A surety who has assumed liability for" for "A guarantor of" at the beginning of the section; and (2) "creditor" for "guarantee" after "is liable to the".

APPENDIX - 5



LEXSTAT CAL CIV CODE SECTION 2809

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Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 13. Suretyship
Article 4. Liability of Sureties

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 2809 (2009)

§ 2809. Measure of liability; Generally

The obligation of a surety must be neither larger in amount nor in other respects more burdensome than that of the principal; and if in its terms it exceeds it, it is reducible in proportion to the principal obligation.

HISTORY:

Enacted 1872. Amended Stats 1939 ch 453 § 20.

NOTES:

Amendments:

1939 Amendment:

Substituted "surety" for "guarantor" after "The obligation of a" at the beginning of the section.



LEXSTAT CAL CIV CODE SEC 2810

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* THIS DOCUMENT REFLECTS ALL URGENCY LEGISLATION ENACTED THROUGH CH. 643 OF *
THE 2009-2010 REG. SESS., CH. 12 OF THE 2009-2010 2d EX. SESS.,
CH. 30 OF THE 2009-10 3d EX. SESS., CH. 24 OF THE 2009-10 4th EX. SESS.,
THE GOVERNOR'S REORG. PLAN #1 OF 2009, EFF. MAY 10, 2009 & PROP 1F APPROVED
EFF. MAY 20, 2009

CIVIL CODE
Division 3. Obligations
Part 4. Obligations Arising from Particular Transactions
Title 13. Suretyship
Article 4. Liability of Sureties

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

Cal Civ Code § 2810 (2009)

§ 2810. Disability of principal

A surety is liable, notwithstanding any mere personal disability of the principal, though the disability be such as to make the contract void against the principal; but he is not liable if for any other reason there is no liability upon the part of the principal at the time of the execution of the contract, or the liability of the principal thereafter ceases, unless the surety has assumed liability with knowledge of the existence of the defense. Where the principal is not liable because of mere personal disability, recovery back by the creditor of any res which formed all or part of the consideration for the contract shall have the effect upon the liability of the surety which is attributed to the recovery back of such a res under the law of sales generally.

HISTORY:

Enacted 1872. Amended Stats 1939 ch 453 § 21.

NOTES:

Amendments:

1939 Amendment:

Cal Civ Code § 2810

Substituted the section for the former section which read: "A guarantor is not liable if the contract of the principal is unlawful; but he is liable notwithstanding any mere personal disability of the principal, though the disability be such as to make the contract void against the principal."

LEXSTAT LEXSTAT CAL CIV CODE SEC 2845

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Cal Civ Code § 2845 (2009)

§ 2845. Surety may require creditor to proceed against principal; Effect of neglect to proceed

A surety may require the creditor, subject to *Section 996.440 of the Code of Civil Procedure*, to proceed against the principal, or to pursue any other remedy in the creditor's power which the surety cannot pursue, and which would lighten the surety's burden; and if the creditor neglects to do so, the surety is exonerated to the extent to which the surety is thereby prejudiced.

HISTORY:

Enacted 1872. Amended Stats 1939 ch 453 § 30; Stats 1972 ch 391 § 1; Stats 1982 ch 517 § 73.



LEXSTAT CAL CIV CODE SEC 2849

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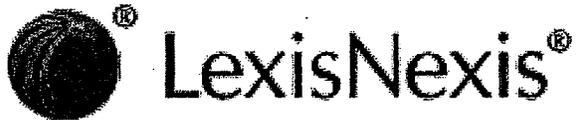
Cal Civ Code § 2849 (2009)

§ 2849. Surety entitled to benefit of securities held by creditor

A surety is entitled to the benefit of every security for the performance of the principal obligation held by the creditor, or by a co-surety at the time of entering into the contract of suretyship, or acquired by him afterwards, whether the surety was aware of the security or not.

HISTORY:

Enacted 1872.



LEXSTAT CAL CIV CODE 2850

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Cal Civ Code § 2850 (2009)

§ 2850. The property of principal to be taken first

Whenever property of a surety is hypothecated with property of the principal, the surety is entitled to have the property of the principal first applied to the discharge of the obligation.

HISTORY:

Enacted 1872.



LEXSTAT CAL CIV CODE SEC 2856

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Cal Civ Code § 2856 (2009)

§ 2856. Waiver

(a) Any guarantor or other surety, including a guarantor of a note or other obligation secured by real property or an estate for years, may waive any or all of the following:

(1) The guarantor or other surety's rights of subrogation, reimbursement, indemnification, and contribution and any other rights and defenses that are or may become available to the guarantor or other surety by reason of Sections 2787 to 2855, inclusive.

(2) Any rights or defenses the guarantor or other surety may have in respect of his or her obligations as a guarantor or other surety by reason of any election of remedies by the creditor.

(3) Any rights or defenses the guarantor or other surety may have because the principal's note or other obligation is secured by real property or an estate for years. These rights or defenses include, but are not limited to, any rights or defenses that are based upon, directly or indirectly, the application of *Section 580a, 580b, 580d, or 726 of the Code of Civil Procedure* to the principal's note or other obligation.

(b) A contractual provision that expresses an intent to waive any or all of the rights and defenses described in subdivision (a) shall be effective to waive these rights and defenses without regard to the inclusion of any particular language or phrases in the contract to waive any rights and defenses or any references to statutory provisions or judicial decisions.

(c) Without limiting any rights of the creditor or any guarantor or other surety to use any other language to express an intent to waive any or all of the rights and defenses described in paragraphs (2) and (3) of subdivision (a), the following provisions in a contract shall effectively waive all rights and defenses described in paragraphs (2) and (3) of subdivision (a):

The guarantor waives all rights and defenses that the guarantor may have because the debtor's debt is secured by real property. This means, among other things:

(1) The creditor may collect from the guarantor without first foreclosing on any real or personal property collateral pledged by the debtor.

(2) If the creditor forecloses on any real property collateral pledged by the debtor:

(A) The amount of the debt may be reduced only by the price for which that collateral is sold at the foreclosure sale, even if the collateral is worth more than the sale price.

(B) The creditor may collect from the guarantor even if the creditor, by foreclosing on the real property collateral, has destroyed any right the guarantor may have to collect from the debtor. This is an unconditional and irrevocable waiver of any rights and defenses the guarantor may have because the debtor's debt is secured by real property. These rights and defenses include, but are not limited to, any rights or defenses based upon *Section 580a, 580b, 580d, or 726 of the Code of Civil Procedure*.

(d) Without limiting any rights of the creditor or any guarantor or other surety to use any other language to express an intent to waive all rights and defenses of the surety by reason of any election of remedies by the creditor, the following provision shall be effective to waive all rights and defenses the guarantor or other surety may have in respect of his or her obligations as a surety by reason of an election of remedies by the creditor:

The guarantor waives all rights and defenses arising out of an election of remedies by the creditor, even though that election of remedies, such as a nonjudicial foreclosure with respect to security for a guaranteed obligation, has destroyed the guarantor's rights of subrogation and reimbursement against the principal by the operation of *Section 580d of the Code of Civil Procedure* or otherwise.

(e) Subdivisions (b), (c), and (d) shall not apply to a guaranty or other type of suretyship obligation made in respect of a loan secured by a deed of trust or mortgage on a dwelling for not more than four families when the dwelling is occupied, entirely or in part, by the borrower and that loan was in fact used to pay all or part of the purchase price of that dwelling.

(f) The validity of a waiver executed before January 1, 1997, shall be determined by the application of the law that existed on the date that the waiver was executed.

HISTORY:

Added Stats 1996 ch 1013 § 2 (AB 2585).