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NO. 66301-1-I

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

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.

BRIEF OF RESPONDENTS

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I. INTRODUCTION

This case is before the Court a second time, having been remanded for a further choice of law analysis last year in the published portion of the Court’s decision found at *Freestone Capital Partners, L.P. v. MKA Real Estate Opportunity Fund I, LLC*, 155 Wn. App. 643, 230 P.3d 625 (2010) [hereinafter “*Freestone I*”]. After repeatedly guaranteeing “unconditional” and “immediate payment” of large sums loaned to their real estate fund by Seattle-based partnerships on promissory notes and security agreements that expressly select Washington law, guarantors Michael Abraham and Jason Sugarman (the “Guarantors”) seek to avoid their obligations by invoking California suretyship defenses. Guarantors – who previously disclaimed any understanding that California law would apply to their guarantees¹ – ask the Court to apply California law because they reside in California, a singular contact which they contend gives California the “most significant relationship” to their payment obligations to the Freestone plaintiffs.

¹ During the limited discovery in this matter on jurisdictional issues, Abraham claimed he did not know what law was selected in the agreements, CP 1140 (Abraham Dep., 12:12-24), and *his counsel (improperly) instructed him not to answer questions about his understanding of the law governing his obligations*. CP 1147 (*Id.* at 39-41). Sugarman testified he “didn’t want to get into” whether the contracts called for the application of Washington law, although he has since read them, and understands that they do. CP 1165 (Sugarman Dep. at 12).

As instructed by this Court, on remand, the trial court carefully analyzed the choice of law issues and concluded that Washington law governs the obligations of Guarantors to the Freestone plaintiffs under the principles set forth in the RESTATEMENT (SECOND) OF CONFLICTS (1971) (the “RESTATEMENT”). CP 972-978. In the alternative, the trial court ruled that even under California law, the Guarantors had waived the asserted conditions to collection by “unconditionally guarant[eeing]” the “immediate payment” (not collection) of all amounts owed to the Freestone plaintiffs by MKA Real Estate Opportunity Fund I, LLC. CP 978-981. The trial court properly rejected Guarantors’ eleventh hour attempt to add a new defense of “exoneration,” finding that the defense was factually and legally deficient, and that further amendment would be futile. CP 961-962.

The trial court’s rulings were correct in all material respects and should be affirmed.

Under the RESTATEMENT, the law governing the guaranteed Notes (Washington) and the place of payment (Washington) are “especially important” contacts in determining the law applicable to the guarantees. Beyond that, Washington is the place of contracting, the place where Freestone negotiated the loans and guarantees, the situs of the subject matter of the guarantees, and Freestone’s domicile. California itself would

apply Washington law to the interpretation of the guarantees, and it has no compelling interest in the application of its waiveable suretyship defenses. In any event, by promising unconditional and immediate payment, the Guarantors waived the right to assert statutory conditions to payment. Guarantors – who either made or reaffirmed their obligations after the date of the Subordination Agreement – cannot claim exoneration.

II. STATEMENT OF THE CASE

A. The Parties

Respondents Freestone Low Volatility Qualified Partners LP, Freestone Capital Qualified Partners L.P., Freestone Low Volatility Partners LP, and Freestone Capital Partners L.P. are limited partnerships based in Seattle, Washington (collectively referred to as “Freestone”). CP 95-96 (¶¶ 4-9). Freestone Capital Management LLC is the investment advisor to all of the Freestone partnerships. *Id.* (¶ 4). Freestone’s offices were located at 1191 Second Avenue (and are now at 1918 Eighth Avenue) in downtown Seattle, and all of the Freestone’s books and records were maintained at those locations. CO 1184 (¶ 4); CP 95 (¶ 5).

The Guarantors, Abraham and Sugarman, each own a 50% interest in MKA Capital Group Advisors, LLC (“MKA Advisors”), a limited liability company based in Newport Beach, California. CP 1140, 1142 (Abraham Dep., 10:2-5; 18:17-22). MKA Advisors manages MKA

Opportunity Fund I, LLC (“MKA”), CP 1139 (Abraham Dep., 7:14-9:15), an investment fund which is in the business of providing financing to developers of commercial and residential real estate projects in various locations throughout the country, including loans on projects in Washington. CP 96 (¶ 15); CP 1141 (Abraham Dep., 17:4-11); CP 1166 (Sugarman Dep., 14).

The Guarantors, who are now portrayed as naive rubes who blindly signed papers that were placed in front of them by “MKA’s lawyer,” are nothing of the sort. Both are calculating and sophisticated businessmen who understood exactly what they were doing, *e.g.*, CP 1195-1201 (describing background of MKA and the Guarantors); CP 1173 (Sugarman Dep. at 44); CP 1219 (2004 abstract touting experience of both Guarantors), and were at certain relevant times represented by Skadden Arps, the number two firm in the AM LAW 100. *See* CP 870-71. The loans and related guarantees were made for the personal benefit of Abraham and Sugarman, interested participants who expected to profit directly from the use of Freestone’s money. *Freestone I*, 155 Wn. App. at 655 (“Guarantors . . . stood to benefit personally from the loans extended to MKA by Freestone.”).

B. Guarantors' Relationship with Freestone and the State of Washington

In 2004, Freestone began corresponding with John Stewart, a “third party marketer” who was used by MKA to raise funds, usually in exchange for a fee. CP 96 (¶¶ 11-12); CP 1165 (Sugarman Dep., 8:5-9:5). Stewart sent Freestone a variety of materials regarding MKA’s business, and he introduced Freestone to MKA’s President, Jason Sugarman. CP 96 (¶ 13) and CP 1193-1219.

Sugarman traveled to Seattle in August 2004 for the purpose educating Freestone on MKA and its business, although Sugarman apparently now does not recall making the trip. CP 96 (¶ 14) and CP 1242-43 (contemporaneous notes of meeting Sugarman “at FCM”); *see* CP 1166 (Sugarman Dep., 15:12-19). Negotiations ensued, and beginning in 2004, certain Freestone entities entered into a lending relationship with MKA. CP 96-97 (¶¶ 14-18). Advances to MKA were evidenced by promissory notes that were initially prepared by MKA’s counsel and then sent to Freestone in Washington by Sugarman. CP 1185 (¶ 12); *e.g.*, CP 376-383; CP 1225-1332. As part of the original advances, Abraham agreed to personally guarantee MKA’s obligations. CP 97 (¶¶ 16-17). If the paperwork was in order and was accepted by Freestone, funds would be advanced to MKA. CP 98 (¶ 20). As recognized by this Court, “The guarantees were a significant inducement to

Freestone agreeing to lend money to MKA.” *Freestone I*, 155 Wn. App. at 654.

Over the following years, Freestone loaned more than \$30 million to MKA at the request of MKA and its managers, Abraham and Sugarman. CP 1186-87 (¶¶16, 18). Freestone was one of only three or four lenders tapped by MKA since 2005, CP 1144 (Abraham Dep., 27:8-20), and MKA persuaded the City of Seattle Pension Fund to become an equity investor in the fund. CP 1143 (*Id.* at 23). Abraham and Sugarman visited Freestone in Seattle in May of 2006 around the time that the first group of promissory notes at issue in this litigation were executed. CP 97 (¶18); CP 1143 (Abraham Dep., 23). The record is replete with evidence of the Guarantors’ extensive correspondence and many calls to Freestone at its Seattle offices during a period stretching from 2004 into 2008. CP 1165 (Sugarman Dep., 12:2-21); CP 1167 (18:14-19) (“if we needed short term money we’d call” Freestone in Seattle); CP 1221-1232; 1234-1244. As this Court found in rejecting Guarantors’ personal jurisdiction defense, “[t]he Guarantors purposefully availed themselves of the privilege of transacting business in the state of Washington.” *Freestone I*, 155 Wn. App. at 650.

The obligations of both MKA and the Guarantors that give rise to this action were documented in nine Secured Promissory Notes (the

“Notes”). CP 104-139. Each of the advances to MKA commencing in May 2006 was evidenced by a Secured Promissory Note that was personally and “unconditionally guarantee[d]” by either Abraham alone, or by both Abraham and Sugarman. *Id.* The Notes and subjoined guarantees were supposedly drafted by “MKA’s counsel,” *but see* CP 1145 (Abraham Dep., 32:9-15) (referring to combined Note/guarantee as “our document”)², although Freestone insisted that the documents provide for the application of Washington law. CP 97 (¶19). “Both the loans and the guarantees are payable to Freestone’s Washington offices.” 155 Wn. App. at 655; CP 101 (¶ 22).

Each of the Notes included the following language:

10. This Note is governed by the laws of the State of Washington, without regard to the choice of law Rules.

...

15. It is the intention of Maker and Lender to conform strictly to the usury laws now or hereafter in force in the State of Washington, and any interest payable under this Note shall be subject to reduction to the amount not in excess of the maximum non-usurious amount allowed under the usury laws of the State of Washington as now or

² Even this weak attempt by Guarantors to somehow suggest that they were ignorant or exploited fails. One of “MKA’s lawyers,” Dan White, represented both Abraham and Sugarman at their depositions in this case. CP 1140-1141 (Sugarman Dep., 13:13-14:2); CP 1138, 1163

hereafter construed by the courts having jurisdiction over such matters.

E.g., CP 106, 107.

Directly below MKA's signature block as Maker, each Note recites a personal guarantee by Abraham, or by both Abraham and Sugarman.

The Guarantors' guarantees read:

THE UNDERSIGNED HEREBY UNCONDITIONALLY GUARANTEES THE PAYMENT OF ALL AMOUNTS DUE UNDER THIS NOTE. UPON DEFAULT OF MAKER TO TIMELY PAY ANY AMOUNT DUE HEREUNDER, LENDER MAY IMMEDIATELY DEMAND, AND THE UNDERSIGNED SHALL IMMEDIATELY PAY, SUCH PAST DUE AMOUNT.

E.g., CP 107 (bold and capitals in original).

As additional security, MKA (through either Abraham or Sugarman) also executed Security Agreements granting security interests in substantially all of its assets to Freestone to secure the amounts due under the Notes. CP 97 (§17); CP 100-01 (§ 21(p)) and CP 195-200.

Each of the Security Agreements contained the following terms:

3. Choice of Law; Unenforceability.
This Agreement shall be construed in accordance with and governed by the local laws (excluding the conflict of law rules, so-

called) of the State [of Washington]³

. . . .

6. Jurisdiction and Venue. The Debtor hereby irrevocably consents that any legal action or proceeding against it or any of its property with respect to any matter arising under or relating to this Agreement may be brought in any court of the State [of Washington] . . . as Lender may elect, and by execution and delivery of this Agreement the Debtor hereby submits to and accepts . . . for itself and its property, generally and unconditionally, the jurisdiction of the aforesaid courts.

CP 198-199. Thus, all of the relevant contract documents between Freestone, MKA and the Guarantors selected Washington law as the law governing the parties' relations, with the express provision that any action against MKA could be brought in Washington under Washington law.

The selection of Washington law was an important issue for Freestone. CP 97 (¶ 19). The Guarantors did not care. The representation to this Court that the Guarantors "expected" California law would apply to the guarantees is false.⁴ App. Brf. at 26. Neither Abraham nor Sugarman had any "expectation" that California law would govern their obligations

³ In the Security Agreements, "State" is a defined term that is defined to mean "the State of Washington."

⁴ In their brief, Guarantors argue that they had a "justified expectation" that California law would govern. The record cites in support of this assertions refer to the Guarantors' understanding of "how guarantees work," not the law that would be applied to the Freestone transactions.

to Freestone, and rather than commit perjury, both refused to answer or dodged questions concerning their understanding of the law that governed the transaction. During limited discovery on jurisdictional issues, Abraham claimed he did not know what law was selected in the agreements, CP 1140 (Abraham Dep., 12:12-24), and his counsel (improperly and inexplicably) instructed him not to answer questions about his understanding of the law governing his obligations. CP 1147 (*Id.* at 39-41). For his part, Sugarman testified he “didn’t want to get into” whether the contracts called for the application of Washington law, although he has since read them, and understands that they do. CP 1165 (Sugarman Dep. at 12).

There are no relevant documents that call for the application of California law, and there is no evidence that anyone suggested California law might apply to the Notes, the guarantees or any aspect of the subject transactions until Guarantors’ lawyers began researching possible affirmative defenses following MKA’s default. After a detailed discussion of the record, the trial court found that Guarantors had no justifiable expectation that California law would apply. CP 976.

C. The Subordination Agreement

In February 2007, MKA requested that Freestone execute a Subordination Agreement in favor of another of MKA’s secured lenders,

Gottex Fund Management, Ltd. (“Gottex”). CP 366-373. The Subordination Agreement provides that Freestone will forbear from taking action against MKA’s assets until another secured creditor, Gottex, has been paid, but provides:

Nothing contained in this Agreement is intended to or shall impair, as between [MKA] and [Freestone], the obligation of [MKA] to pay the [Freestone notes] as and when the same shall become due and payable . . . nor shall anything herein prevent [Freestone] from exercising all remedies otherwise permitted by applicable law or under or with respect to the [Freestone notes] upon default, subject to the restrictions set forth in this Agreement

...

CP 369 (¶ 13). Thus, by its own terms, the Subordination Agreement expressly permitted Freestone to pursue its remedies against the Guarantors in the event MKA defaulted on the Notes. There was no evidence that the Subordination Agreement means anything other than what it says, and this Court so found in *Freestone I*. 155 Wn. App. at 672. While Guarantors now argue that the Subordination Agreement somehow harmed their interests, there is no competent evidence that this is the case.⁵

⁵ Guarantors note that Freestone had “broad security interests in substantially all of MKA’s assets,” App. Brf. at 7, but so did Gottex, CP 366, and the record is devoid of evidence that Freestone’s interests were ever senior to the interests of Gottex or were impaired in any way by the Subordination Agreement. Indeed, Abraham testified that Gottex’s interests were senior to Freestone’s before the Subordination Agreement. CP 1153 (Abraham Dep., 64-65).

D. MKA and the Guarantors Request Note Extension Agreements, and Guarantors Affirm Their Obligation of Immediate Payment on the Extended Due Dates

MKA was unable to meet its obligations to Freestone, and on or about February 21, 2008 (more than a year after the Subordination Agreement was signed), Freestone, MKA, *and the Guarantors* entered into Note Extension Agreements in which (a) MKA reaffirmed and ratified its obligations to Freestone, (b) Abraham and Sugarman reaffirmed their guarantees, and (c) all of the defendants (including the Guarantors) agreed to provide detailed information regarding MKA's financial condition and the condition of its loan portfolio to Freestone on a regular basis. CP 99-100 (¶ 21(j)-(m)) and CP 140-183.

As consideration for an extension of the due dates, CP 145 (¶ 13), Abraham and Sugarman expressly reaffirmed their unconditional guarantees of immediate payment of the obligations of MKA, stating:

Reaffirmation of Guarantee. Guarantor hereby reaffirms his guarantee of the obligations of MKA under the [Notes] and further acknowledges that the amount[s] and due date[s] of the obligations under the [Notes] set forth in the Recitals are correct, and that *in the absence of payment by MKA, he is and continues to be obligated to immediately pay all amounts due under the [Notes].*

E.g., CP 142 (¶ 2) (emphasis added). Thus, as in the original guarantees, the Guarantors affirmed the amounts, due dates, and their obligation to “immediately pay” amounts due on the Notes.

The parties, including the Guarantors, executed two amendments to each of the Note Extension Agreements, extending the maturity dates to May 31, 2008. *E.g.*, CP 100 (¶ 21(n)-(o)) and CP 184-193. Each of the amendments to the Note Extension Agreements expressly provides that “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 conflict of law provisions.” CP 186 (¶ 5) and CP 191 (¶ 6).

Notably, while the Guarantors unsuccessfully argued that Freestone had violated the Subordination Agreement in *Freestone I*, the Guarantors did *not* claim that the Subordination Agreement in any way “exonerated” or “impaired” their guarantees. This is not surprising given that the evidence was that both Sugarman (who was involved in the preparation of the Subordination Agreement) and Abraham (who testified that he read it) knew about the Subordination Agreement when they reaffirmed their promises to make “immediate payment” on the MKA Notes as and when due.⁶ CP 902-913; 870-71. The three guarantees

⁶ Beyond Guarantors’ indisputable affirmation of their obligations with knowledge of the Subordination Agreement, Freestone is in no way waiving any other arguments against

executed by Abraham and Sugarman in April 2007 were made *after* the Subordination Agreement, and by definition, the Agreement did not “impair” any preexisting rights. CP 1175 (Sugarman Dep., 50:15-18). Abraham, who assuredly knew about the MKA’s negotiations with its two secured lenders, expressly reaffirmed his obligations under the six guarantees that were then in existence *with knowledge of* the Subordination Agreement. CP 1153 (Abraham Dep., 63:13-25) (confirming Abraham read the Subordination Agreement before signing the Note Extension Agreements, and has never expressed any objections). Indeed, it was defendants’ lawyers from Skadden Arps who provided the Subordination Agreement to Freestone’s new counsel as part of the extension negotiations in early 2008, CP 870 (¶ 4), and those same lawyers who tried to delete the affirmation of the guarantees from the Note Extension Agreements that were made in February 2008. *See* CP 877 (showing proposed deletion of reaffirmation). Freestone insisted that the reaffirmation language be included. CP 885 (¶2) (reinserting reaffirmation of guarantees). Guarantors acceded. CP 870-71.

MKA did not pay the amounts due to Freestone on or before May 31, 2008, as required. CP 101 (¶ 23). On July 30, 2008, Freestone sent notices of default to MKA, and demand letters were sent to the

application of § 2819 or similar laws, including the fact that the statute only applies “except so far as he or she may be indemnified by the principal.”

Guarantors giving notice that unless payment was made on or before August 7, 2008, Freestone reserved its right to commence legal action. CP 1189 (¶ 24) and CP 1333-1335; 1337-1339.

E. Brief Procedural History

On September 2, 2008, Freestone filed suit in King County Superior Court against MKA, MKA Advisors, and the Guarantors. The lawsuit included a request for a declaration that MKA was in default, a demand for immediate payment by the Guarantors, and a claim that all four defendants were violating the reporting obligations in the Note Extension Agreements. CP 9-26; 1189-90 (¶ 26).

After giving notice to defendants, Freestone secured a temporary restraining order compelling defendants to comply with their reporting obligations. From that point forward, there was essentially continuous motion practice, with Freestone trying to efficiently drive the case to resolution, and the defendants seeking to avoid or delay judgment as long as possible, including motions by defendants to stay the proceedings in favor of anticipatory litigation filed by the Guarantors in Orange County, a motion to dismiss for lack of personal jurisdiction, a motion to dismiss for lack of subject matter jurisdiction, and even a motion for discretionary review of the order denying their motion to stay the case.

The defendants lost on every issue, and judgments were entered in favor of Freestone. This Court affirmed in all respects,⁷ save for the question of the law applicable to Guarantors' payment obligations to Freestone which was remanded for further analysis by the trial court.

III. ARGUMENT

A. Summary of Argument

The issue before the Court is whether the Guarantors are obligated to make unconditional and immediate payment of the amounts owed to Freestone, or whether the Guarantors can assert statutory conditions to payment under California law. The trial court correctly concluded that the Guarantors' payment obligations are governed by Washington law, and that even under California law, Guarantors are required to make immediate payment, as promised. The trial court properly rejected the new defense of exoneration as futile given the application of Washington law, as well as Guarantors' express affirmation of their obligations after (and with knowledge of and involvement in the preparation of) the Subordination Agreement.

⁷ In the unpublished portion of the decision, the Court expressed some discomfort with the award of fees to Freestone, but felt compelled to affirm the availability of fees based on what it considered to be binding Supreme Court precedent. Because it has become increasingly improbable that Freestone will recover the principal and interest owed to it, on remand, Freestone elected to forego its claim for fees, and the judgments entered against Guarantors below do not include an award of fees or expenses. *See* CP 231.

First, under any reasonable analysis, the Guarantors' obligations to Freestone are governed by Washington law:

- Washington courts have consistently applied the principles set forth in the RESTATEMENT (SECOND) OF CONFLICTS (the "RESTATEMENT") to decide choice of law issues. Washington law is the law expressly selected in the guaranteed Notes, and it is the law that is properly applied to the guarantees under RESTATEMENT § 194, the section of the RESTATEMENT that supplies the specific rule for suretyship obligations.
- Washington is the place where repayment is to be made, and its laws also apply to the guarantees under Section 195 of the RESTATEMENT, a section which speaks to repayment obligations generally.
- Even if the Court were, like Guarantors, to ignore the rules in Sections 194 and 195, under a generic contractual choice of law analysis, Washington is the place of contracting, the place where many of the negotiations took place, the place of performance, the situs of the "subject matter" of the contract, Freestone's domicile, and it has the most significant relationship to the Guarantors' payment obligations to Freestone. *Id.*, § 188.
- And, finally, even if "California law" were selected, California would apply Washington law. CAL. CIV. CODE § 1646. California has no material interest in seeing its waiveable suretyship defenses applied to repayment obligations arising from contracts that were made and are payable in Washington, and the guarantees should be interpreted as absolute and unconditional guarantees under Washington law.

Washington law applies - and was properly applied - to the Guarantors' payment obligations to Freestone.

Second, if for some reason the law of California (with the lone exception of § 1646 of the CALIFORNIA CIVIL CODE) were to apply, Guarantors waived their “debtor first” and other defenses to immediate payment in the language of the guarantees. The Guarantors plainly and unequivocally promised to make unconditional and immediate *payment* on the Notes. As Guarantors concede, the statutory conditions they assert can be waived without any magic words, and it is simply impossible to reconcile their promise of “immediate payment” with the arguments now advanced by their lawyers – that payment must await various conditions.

Third, Guarantors’ belated argument that the Subordination Agreement somehow “exonerates” them fails. The defense is not available to them under Washington law, nor is it available under California law where some of the guarantees were made well after the Subordination Agreement, and the Guarantors expressly reaffirmed their obligation to make immediate payment with knowledge of the agreement.

B. Appropriate Standard of Review for Findings in Support of Choice of Law

While the analysis of the applicable law is a legal question that is reviewed *de novo*, *McKee v. AT&T Corp.*, 164 Wn.2d 372, 191 P.3d 845 (2008), deference should be given to the trial court’s findings in support of

it choice of law ruling.⁸ Under no circumstances are Guarantors entitled to “inferences” in their favor in connection with the choice of law (as opposed to summary judgment) rulings.⁹

C. Washington, Not California, Law Governs Guarantors’ Payment Obligations to Freestone

Hoping to pique this Court’s interest in their appeal based on the trial court’s comment that waiver presented a “close call,” the Guarantors open their briefing with argument on waiver. While the trial court made an alternate finding of waiver, the entry of judgments in favor of Freestone was based first and foremost on the court’s choice of law analysis under the RESTATEMENT. Judge Rogers ruled that Guarantors’ payment

⁸ Freestone did not identify any Washington decisions addressing this issue in the choice of law context, but Freestone submits that an appropriate analytical framework is outlined in *In re Riddell*, 138 Wn. App. 485, 491-92, 157 P.3d 888 (2007) (“[T]his case presents a mixed question of law and fact. We give deference to the trial court’s factual findings in regard to the trust, but we review the trial court’s decision to deny equitable relief and not modify the trust *de novo*.”). This is consistent with federal law. See *Zipfel v. Haliburton*, 832 F.2d 1477, 1482 (9th Cir. 1987) (“We review under the clearly erroneous standard the district court’s findings of fact underlying its choice of law determination.”); *Trierweiler v. Croxton Trench Holding Co.*, 90 F.3d 1532, 1535 (10th Cir. 1996) (“We review choice of law determinations *de novo*, and findings of fact underlying those determinations for clear error.”). Freestone notes authority to the effect that findings on written materials are generally reviewed *de novo*. E.g., *Truly v. Heuft*, 138 Wn. App. 913, 916, 158 P.3d 1276 (2007).

⁹ Were this not the rule, trial judges would be unable to make rulings on the applicable law – rulings necessary for summary judgment, jury instructions, and trial – without giving *both* sides the ping-ponging benefit of any supposedly disputed facts and inferences therefrom, a situation which is “completely unacceptable.” *Villar v. Crowley Maritime Corp.*, 782 F.2d 1478, 1479 (9th Cir. 1986) (rejecting argument that trial court cannot decide disputed facts as part of choice of law analysis; “a district court may have to resolve disputed factual issues involved in the choice of law determination before a trial on the merits”).

obligations to Freestone are governed by Washington law, and properly so. This ruling defeats all of Guarantors' defenses, including the latest arguments concerning "exoneration," and the judgments in favor of Freestone are properly affirmed on this basis.¹⁰

1. Washington law, the law chosen to govern the underlying obligations and the law of the place of payment, governs the guarantees.

In the original proceeding, the trial court ruled that the parties had expressly selected Washington law to govern the guarantees by virtue of the choice of law clauses in the Notes and other contract documents. This Court rejected that analysis in *Freestone I*, but declined to make a ruling on choice of law; the Court instead remanded the issue to the trial court for an analysis in the first instance, including an analysis of how Section 194 and other sections of the RESTATEMENT (SECOND) OF CONFLICTS are properly applied in the selection of the law applicable to the guarantees appended to the Notes. 155 Wn. App. at 667-668.¹¹ After carefully

¹⁰ It was only after Freestone had filed their renewed motion for summary judgment after remand that Guarantors sought leave to add a new defense of exoneration under CAL. CIV. CODE. § 2819. As Guarantors' theories continually morphed, the choice of law question and the possibility of a "false conflict" began to create an endless analytical loop. As such, the trial court first decided the choice of law question, and made alternate findings on select issues that also defeated Guarantors arguments.

¹¹ In *Freestone I*, this Court did *not* state that the "factors set forth § 188 determine the law applicable to suretyship contracts . . . even considering § 194." App. Brf. at 23. The Court did not state that the law selected to govern the guaranteed obligation should not be considered an "especially significant contact," nor did it comment on the weight that should be afforded to the contacts identified in Sections 194 and 195. Guarantors avoid

reviewing both the evidentiary record and the law, the trial court concluded that Washington law is properly applied to the Guarantors' payment obligations under the RESTATEMENT.

There is no question that the RESTATEMENT supplies the choice of law rules in this case. Washington courts have routinely applied the RESTATEMENT to decide choice of law issues, including rules crafted for lender-borrower relationships, *e.g.*, *O'Brien v. Shearson Hayden Stone, Inc.*, 93 Wn.2d 51, 605 P.2d 779 (1980) (both majority and dissent applying Section 203 of the RESTATEMENT on usury to choice of law analysis), and while one would not know it from reading the Guarantors' brief, the RESTATEMENT provides a specific rule for this very case.

Although no Washington appellate court has had occasion to consider the issue,¹² the RESTATEMENT and decisions interpreting it make clear that Section 194, not a generic counting of contacts, is appropriately applied to determine the law applicable to the performance of the

these sections because they have no answer to them, not because of instructions from this Court.

¹² Washington has never rejected the application of Section 194 to issues of performance of suretyship contracts, and until this case, has never been asked to apply it. A handful of decisions, starting with *Potlatch No. 1. Fed. Credit Union v. Kennedy*, 76 Wn.2d 806, 809, 459 P.2d 32 (1969) (a case decided when Section 194 was still in draft form) have applied a "most significant contacts" analysis to guarantees, generally with respect to community liability, a subject which is of unique interest to the spouses' home state. *G.W. Equip. Leasing, Inc. v. Mt. McKinley Fence Co.*, 97 Wn. App. 191, 196 (1999) ("when management of community property is at issue, the state with the most significant interests is typically the state where the spouses reside"). The discussion in *Granite Equipment Leasing Corp. v. Hutton*, 84 Wn.2d 320, 323-24, 525 P.2d 223 (1974) is purely dicta given the parties' failure to argue foreign law.

guarantees appended to the Notes. Indeed, Washington has adopted Section 188 of the Restatement, *McKee*, 164 Wn.2d at 383-84; *O'Brien*, 93 Wn.2d at 58, and the very language of Section 188(3) of the RESTATEMENT refers the reader to Section 194 in this case. To date, Guarantors have offered no reason why Section 194 does not state the appropriate rule or why that rule should not be applied here. Instead, Guarantors simply ignore the specific rule applicable to this case, arguing, in effect, that the Guarantors' residence is the only relevant consideration and that a subjoined guarantee is no different than any other contract.

Section 188 sets forth what the RESTATEMENT describes as “general principles” applicable to most contracts. The RESTATEMENT goes on, however, to provide more specific rules for nine specific categories of “particular contracts.” The Introductory Note to these sections states:

Introduction Note. This Title deals with particular kinds of contracts. These contracts are given special attention because *it is considered possible to state with respect to each that*, in the absence of an effective choice of law by the parties, *a particular contract plays an especially important role* in the determination of the state of the applicable law.

(Emphasis added.) *Shannon-Vail Five Inc. v. Bunch*, 270 F.3d 1207 (9th Cir. 2001) (a case cited by Guarantors and this Court in *Freestone I*),

summarized the relationship between the general rules of Section 188 and the more specific rules of the following sections:

Immediately following § 188 are sections providing more specific criteria for particular types of contracts. *See* Restatement §§ 189-197. ***The Restatement contemplates that these subsequent sections will be used to decide choice of law in such contracts.***

Id. at 1211 (emphasis added); *see also Babcock & Wilcox Co. v. Arkwright-Boston Mfg. Mut. Ins. Co.*, 867 F. Supp. 573, 582 (N.D. Ohio 1992) (“Sections 189-197 state specific principles applicable to particular types of contracts. Thus, these sections together form a continuous and harmonious scheme for the analysis of choice of law questions regarding contract disputes.”).

Contracts of suretyship, which include guarantees, constitute one of the nine categories of contracts for which a specific rule is provided in Section 194. Thus, in contrast to Section 188, which lists five contracts to be taken into account, contracts of suretyship are to be analyzed under a specific rule that gives preeminence to one particular consideration that is not listed in § 188. That rule is as follows:

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 § 194 (emphasis added) [set forth with comments and notes at CP 234-236]. The presumption that the same law governs both the guarantee and the principal obligation is logically based on the relationship between the agreements: The guarantee and the principal obligation “will usually be closely related and have many common elements,” and this presumption applies with particular force when the agreements were executed contemporaneously in the same instrument. *Id.* cmt. b.

Thus, in the absence of extraordinary circumstances or considerations (none of which are present here), application of the law governing the principal obligation to a contract of guarantee is presumptively proper.¹³ There is no question that the law governing the

¹³ See, e.g., *Am. State Bank v. U.S. Fidelity & Guar. Co.*, 331 F.2d 479, 482 (7th Cir. 1964) (the law governing the underlying obligation applies to suretyship contracts, and here the law of the place of performance of that contract applied to the performance bond); *Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F. Supp. 91, 94 (D.R.I. 1993) (applying RESTATEMENT 194 and holding choice of law provision in subcontract applied to performance bond, which lacked its own choice of law provision; “no need to assess the interests other states may have in the transaction” because the creditor seeking to enforce the bond had its principal place of business in the chosen state (citing Restatement § 194 cmt. c)); *Process & Storage Vessels, Inc. v. Tank Serv., Inc.*, 541 F.

principal obligation in this case is the law of the State of Washington. Section 10 of the Notes expressly provides that: “This Note is governed by the laws of the State of Washington, without regard to the choice of law rules of that state.” *E.g.* CP 106 (¶ 10). Section 15 echoes that choice, noting that the parties intend that the usury laws of the State of Washington govern the Note. CP 107 (¶ 15). The security agreements and subsequent extension agreements only reinforce the point that these transactions, including the obligations of the Guarantors, would be governed by Washington law. Washington law is thus the law indicated

Supp. 725, 730 (D. Del. 1982) (applying Restatement 194 and concluding the law governing the principal obligation applied where the underlying contract and payment bond were both to be performed in that state; “this performance factor is singularly persuasive on the choice of law issue”); *CBS, Inc. v. Film Corp. of Am.*, 545 F. Supp. 1382, 1386 (E.D. Pa. 1982) (the law governing the principal obligation, New York, applied to the guaranty because, among other things, the contract was performed in New York and credit was extended there; these factors outweighed places of incorporation or principal places of business); *id.* at 1386 (“[I]n the majority of cases, courts have held that the law governing the suretyship contract is the local law of the state where the creditor acted upon the guaranty by extending credit.”); *Phoenix Arbor Plaza, Ltd. v. Dauderman*, 163 Az. 27, 785 P.2d 1215, 1218 (Ariz. Ct. App. 1989) (after concluding the choice of law provision in the underlying lease did not apply to the guaranty, the court applied the Restatement 194 analysis to the guaranty and held that because Arizona was the place of “execution, negotiation and performance of the contract and the site of the leasehold underlying the guarantee,” that law governed; “The only connection that California had with the transaction at the time it was executed was that the [guarantors] were residents of California.”); *Cashman Equip. Corp. v. U.S. Fire Ins. Co.*, 368 Fed. Appx. 288, 2010 WL 746423 at *3 (3d Cir. Mar. 5, 2010) (not selected for publ’n) (“The Bond Agreement is silent as to which state’s law should apply to it, which means that ‘the law governing the principal obligation which the contract of suretyship was intended to secure’ likewise governs the Bond Agreement.”); *id.* at *3-4 & n.6 (predicting Pennsylvania’s Supreme Court will likely “follow the majority of jurisdictions and adopt [Restatement § 194],” and collecting cases); *In re Technology for Energy Corp.*, 88 B.R. 182, 186 (E.D. Tenn. 1988) (“The logic supporting § 194 is sound . . . Clearly, the purchase orders and bonds are closely related . . . hence, it logically follows that New Jersey law should also govern its claims against American under the performance and payment bonds mandated by those purchase orders.”).

by Section 194; the explicit choice of Washington law in the Notes is a critical consideration that is utterly ignored by Guarantors.

Even if the Notes were silent as to law governing the guaranteed obligations, however, Section 195 of the RESTATEMENT, another one of the special provisions governing particular type of contracts, provides:

The *validity of a contract for the repayment of money lent and the rights created thereby are determined*, in the absence of an effective choice of law by the parties, *by the local law of the state where the contract requires that repayment be made*, 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.

(Emphasis added). Here, the Notes provide that payment is to be made “at such address as Lender from time to time may designate in writing.” CP 105. This Court has already found that payments were to be made to Freestone in Washington, 155 Wn. App. at 655 (“Both the loans and the guarantees are payable to Freestone’s Washington offices.”), which is consistent with payment history prior to execution of the Notes. Guarantors argument that there was no agreed place of payment, App. Brf. at 28, is incorrect. Washington law is the law indicated by Section 195. *See Dennis Joslin Co. LLC v. Robinson Broadcasting Corp.*, 977 F.

Supp. 491, 494 n.3 (D.D.C. 1997) (applying Section 195 and noting that location of collateral was “irrelevant”).

In *Freestone I*, the Court suggested that the clause beginning with the word “unless” in Section 194 (which also appears in Section 195) might make the analysis of whether Washington or California law should apply “more complex.” 155 Wn. App. at 667. But this is not so here, because California’s only supposed interest in whether Guarantors are asked to pay Freestone now is that the Guarantors reside in California. The Guarantors’ residence does not trump the presumption created by the RESTATEMENT or Washington’s manifest interest in seeing its residents repaid on funds loaned out of Washington, under notes governed by Washington law, secured by security agreements created under Washington law, to be repaid to the lenders at their Washington offices. Guarantors’ residence does not affect the place of performance or the place of contracting – also Washington – and, as discussed below, California simply has no compelling interest in seeing waiveable laws applied in this case. See *Pearl v. Gen. Motors Acceptance Corp.*, 13 Cal. App. 4th 1023, 1029, 16 Cal. Rptr. 2d 805 (Cal. Ct. App. 1993) (“Sections 2845 and 2849 have often been found to have been waived . . . [t]hese rights were not viewed by the courts as so founded in public policy as to preclude their waiver by the sureties.”).

It is apparent that although the drafters of RESTATEMENT Sections 194 and 195 allowed for the case in which a particular jurisdiction has some compelling interest in a specific issue related to or arising under a contract of suretyship, an analysis of the law selected under Sections 194 and 195 does not devolve into a generic, circular analysis of which state has a more significant relationship. Comment c to Section 194 states that “[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.” Here, Washington satisfies *all* of these alternative grounds for application of the presumptively appropriate law.

Washington law was expected to govern the subject transactions: Washington law was expressly selected to govern the Notes, the related security agreements, and a series of other extension agreements signed by

the Guarantors. Freestone insisted on Washington law and understood that Washington law would govern, CP 97 (¶ 19), while Guarantors testified that they *did not consider* the issue, and had no “expectation” – let alone a reasonable one – that California law would apply. CP 1140, 1146 (Abraham Dep. at 12-13, 34) (claiming he did not know what law was selected in contracts he signed); CP 1165 (Sugarman Dep. at 12) (claiming he did not know what law was selected). Guarantors do not dispute that Washington is the place from which money was loaned and was to be repaid, and that it is the site of the “subject matter” of the guarantees. *See Granite Eq. Leasing*. Washington is the place where the Notes and guarantees were accepted, giving rise to binding obligations. The only relevant “contacts” with California are that Guarantors happened to reside and claim to have signed the guarantees there before sending them to Seattle. Washington has the most significant contacts - including the “especially important” ones identified by the RESTATEMENT.

In sum, the law of Washington – the law selected to govern the principal obligation, the place of contracting, and the place where repayment was to be made – is the law that applies to the guarantees under the choice of law rules crafted for precisely this sort of case. As Guarantors point out, “some contacts are more important than others.” App. Brf. at 23 n.9. Because both of the “especially important” contacts

identified in the RESTATEMENT call for the application of Washington law, Washington law should govern. To ignore these rules in favor of Guarantors' residence would defeat the purpose of the rules, rendering the ALI's careful work a nullity. Washington is the state with the most significant relationship to the obligations under the guarantees, and California has scant interest in seeing its laws applied here. The Court should look to the RESTATEMENT and apply Washington law.¹⁴

2. Even under a generic “contract” analysis, Washington law applies.

Even if the specific sections of the RESTATEMENT that govern the facts of this case and the weight of the cases analyzing guarantees did not call for the application of Washington law (which they do), and even if one were to simply disregard the law selected to govern the underlying obligation as well as the other aspects of the lending relationship (as Guarantors propose to do in their analysis), the result would be the same under Section 188, which provides the generic guidelines that are advocated by Guarantors. Under Section 188(2) of the RESTATEMENT, the contacts to be taken into consideration when specific rules such as

¹⁴ At various points in their brief, Guarantors chide the trial court and Freestone for “blurr[ing] the transactions” without sufficient focus on the guarantees. App. Brf. at 34. Of course, most of Guarantors statement of the case has nothing to do with the guarantees, but instead discusses things like where MKA loaned money, where collateral was located, and a variety of other matters that are irrelevant to the issue before the Court.

Sections 194 and 195 do not apply are (i) the place of contracting, (ii) the place of negotiation, (iii) the place of performance, (iv) the location of the subject matter of the contract, and (v) the residence of the parties. Here, these contacts call for the application of Washington law:

- Washington, the place where the guarantees became enforceable by reason of their acceptance and the subsequent advance of funds, is the place of contracting.¹⁵ RESTATEMENT (SECOND) OF CONFLICTS § 188 cmt. e (“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”); *Ball-Foster Glass Container Co. v. Giovanelli*, 128 Wn. App. 846, 853, 117 P.3d 365 (2005), *aff’d*, 163 Wn.2d 133 (2008) (“[A] contract is considered as having been entered into at the place where the offer is accepted or where the last act necessary to a meeting of the minds or to complete the contract is performed.”); *Norm Advertising v. Monroe Street Lumber Co.*, 25 Wn.2d 391, 396, 171 P.2d 177 (1946) (same); *Developers Small Bus. Inv. Corp. v. Hoeckle*, 395 F.2d 80 (9th Cir. 1968); *CBS, Inc. v. Film Corp. of America*, 545 F. Supp. 1382, 1387 (E.D. Pa. 1982); *Watson v. Lehigh Valley Woodwork Corp.*, 198 F. Supp. 273, 275-76 (E.D.Pa. 1961).¹⁶

¹⁵ In its oral ruling, the trial court indicated that California was the place of contracting. CP 974. This was error as signing the documents did not give rise to a contract, the advance of funds did.

¹⁶ Guarantors state that the place where the guarantees were signed is the “place of contracting,” citing *Granite Equipment Leasing, supra*, and *Wilson Court L.P. v. Tony Maroni’s, Inc.*, 134 Wn.2d 692, 710, 952 P.2d 590 (1998). App. Brf. at 27-28. It is questionable whether the court in *Granite Equipment Leasing* made such a ruling and it certainly did no analysis. *Wilson Court* does not so hold, is not a choice of law case, and the “quote” is from a parenthetical from a Mississippi decision that is part of a string cite. There is no binding contract unless and until there is an advance of funds in reliance on the guarantor’s promise, and the loan (or acceptance) is the “last act necessary to bind the parties.” See *Moore v. Luxor (North America) Corp.*, 294 Ark. 326, 742 S.W.2d 916 (Ark. 1988) (“Although the security agreement and the guarantee agreements were sent by the Washington company to Arkansas to be signed . . . the final act of acceptance occurred in Washington when credit was extended on the basis of those agreements.”);

- To the extent there were “negotiations,” they took place between Washington and California. 155 Wn. App. at 654-58.
- The “place of performance” on the guarantees was Washington, where Freestone was located and was to be repaid. *Id.* at 655, 658.
- The “subject matter” of the guarantees was the repayment of the money loaned by Freestone, which is considered to be Washington. *See Granite Equipment Leasing Corp. v. Hutton*, 84 Wn.2d 320, 325, 525 P.2d 223 (1974) (situs of the “subject matter” of guaranty is the domicile of the owner).

This leaves Guarantors to argue that their residency should trump all of the other considerations that militate in favor Washington law (including Freestone’s Washington residence), an argument that would turn commercial law on its head. If the law were that the law of a guarantor’s residence controls whenever it will serve to *deprive* the lender of payment, the RESTATEMENT and the case law would say so.¹⁷

Applying Washington law to the guarantees furthers the needs of interstate systems; furthers relevant Washington policies; furthers justified expectations; furthers the basic policies underlying commercial lending

Cal. Civ. Code § 2795 (offer to become a surety accepted by acting on it). Had Guarantors canceled the guarantees after signing but before funds were advanced, there would have been no contract to do anything. *See Bank of California v. Union Packing Co.*, 60 Wash. 456, 461, 111 P.573 (1910) (guarantee is “an offer . . . on the part of the guarantor which does not become effective and binding as an obligation until accepted . . . until then it is inchoate and incomplete, and may be withdrawn by the proposer”).

¹⁷ This analysis is directly contrary to general choice of principles that strive to apply the law of “the place under whose local law the contract will be most effective.” *Baffin Land Corp. v. Monticello Motor Inn, Inc.*, 70 Wn.2d 893, 901, 425 P.2d 623 (1967); *see also* RESTATEMENT, § 194 cmt. c (may be reason not to apply the law governing the principal obligation where suretyship invalid under that law).

law; promotes certainty, predictability and uniformity of result; and ease of determination. *See* RESTATEMENT, § 6.

California’s supposedly “competing interest” (which is at best *de minimis*) does not change the result.¹⁸ As discussed below, the suretyship sections invoked by Guarantors do not reflect a “strong” California policy; California itself would apply Washington law without hesitation. For its part, Washington has a compelling interest in seeing *its* law on the meaning of absolute and unconditional guarantees applied. *Potlatch No. 1*, 76 Wn.2d at 811-12 (noting that plaintiff’s domicile and place of payment has “obvious governmental interests,” and describing competing interest as “equally vital”).¹⁹ Public policy is reflected in statutes *and* judicial decisions, *Wahl v. Dash Point Family Dental Clinic, Inc.*, 144 Wn. App. 34, 42, 181 P.3d 864 (2008); California’s interest is no greater than Washington’s, and Guarantors cite no authority for the proposition that it is. RESTATEMENT, § 6 cmt. e (“Every rule of law, whether

¹⁸ In support of their arguments, Guarantors cite *Business Loan Center, LLC v. Nischal*, 331 F. Supp.2d 301, 309 (D.N.J. 2009), a New Jersey case concerning the requirements of a real property foreclosure in Georgia. Unlike here, there was no law selected to govern anything in *Nischal*. The court looked to the presumptive importance of the location of the foreclosed property, and found it was appropriate to apply Georgia foreclosure law to foreclosure of a Georgia property, citing Section 229 of the RESTATEMENT. *Nischal* does not support the proposition that a guarantor’s residence is a consideration, let alone an important one: The individual defendants in *Nischal* actually lived in New Jersey, further undermining Guarantors’ arguments.

¹⁹ *See St. Jude Medical S.C. Inc. v. Hasty*, 2007 WL 128856 (D. Minn. 2007) (“Minnesota has a strong governmental interest in having its contract laws enforced”); *Medtronic, Inc. v. Advanced Bionics Corp.*, 630 N.W.2d 438, 455 (Minn. Ct. App. 2001) (refusing to apply California statute to invalidate non-compete).

embodied in a statute or in a common law rule, was designed to achieve one or more purposes.”); *Fluke Corp. v. Hartford Acc. & Indemn. Co.*, 102 Wn. App. 237, 253, 7 P.3d 825 (2000), *aff’d*, 145 Wn.2d 137 (2001) (“Under sections 188 and 6, California's expressed public policy does not outweigh other factors pointing to Washington as having the most significant relationship with the contract.”).

In support of its arguments for the application California law, Guarantors cite a handful of Washington decisions over the past 40 years, suggesting that they inform the outcome here. In the few cases in which guarantees have been discussed as part of a choice of law analysis, the issue has often been whether the assets of a spouse who is not a signatory to the guarantee are subject to the guaranteed obligations. This is an issue of community liability, not suretyship, and the cases do not stand for the proposition that “guarantors’ location is decisive.” App. Brf. at 33; *G.W. Equip. Leasing, Inc. v. Mt. McKinley Fence Co.*, 97 Wn. App. 191, 196, 982 P.2d 114 (1999) (“when management of community property is at issue, the state with the most significant interests is typically the state where the spouses reside”); *Potlatch* (issue of community liability of wife who did not sign agreement); *see* 15 Karl A. Tegland, WASHINGTON PRACTICE: CIVIL PROCEDURE § 54:1 (2010) (*Potlatch* and *Pacific Gamble* are cited as giving guidance on the law applicable to the obligations of

marital communities); *see also Pacific Gamble Robinson Co. v. Lapp*, 95 Wn.2d 341, 622 P.2d 850 (1980) (Washington had “no connection” to transaction until defendants moved, and parties agreed that Colorado law governed debt).

3. California would apply Washington law to the guarantees.

Even if a court were to conclude that “California law” is properly applied to the guarantees, the CALIFORNIA CIVIL CODE itself calls for the application of Washington law. Section 1646 of the CALIFORNIA CIVIL CODE provides that “[a] contract is to be interpreted according to the law and usage of the place *where it is to be performed*, or, if it does not indicate a place of performance, according to the law and usage of the place *where it is made*.” (emphasis added); *Cohen v. Formula Plus, Inc.*, ___ F. Supp.2d ___, 2010 WL 4608761 at *3 (D. Del. 2010) (“California resolves the [choice of law] issue by statute.”); *Frontier Oil Corp. v. RLI Ins. Co.*, 63 Cal. Rptr. 3d 816, 836 (Cal. Ct. App. 2007). The parties’ residence is of no particular import to California. Here, as discussed above, performance of the guarantees was to take place in Washington, 155 Wn. App. at 658 (“Both the loans and the guarantees were to be paid in Washington.”), which is also considered the place where the contract of guarantee was made. *E.g., Developers Small Bus. Inv. Corp. v. Hoeckle*,

395 F.2d 80 (9th Cir. 1968). Guarantors cannot pick and choose provisions in the Civil Code, and that Code states that the guarantees are interpreted according to the “law and usage” of Washington, law which by Guarantors’ own admission does not offer the suretyship defenses asserted in this case, and that interprets an unconditional guarantee as precluding such defenses.

On facts similar to those in this case, the United States Court of Appeals for the Ninth Circuit, reading California law, concluded that New Jersey law applied to the obligations of guarantors who were seeking to assert rights under California law. *Developers Small Bus. Inv. Corp.*, *supra*. Citing Section 1646 of the CALIFORNIA CIVIL CODE, the court found that the guaranty was made when and where the funds were loaned, stating:

In determining the place of making, suretyship contracts differ from regular contracts since the creditor must accept the surety’s guarantee, either by acting upon it and extending credit, or by communicating his acceptance to the surety. *Skaggs-Stone, Inc. v. LaBatt*, 182 Cal. App. 2d 142, 5 Cal. Rptr. 882 (1960). This event clearly occurred in New Jersey.

Id. at 83; *see also Pratt v. Dittmer*, 51 Cal.App. 512, 517, 197 P. 365 (Cal. Ct. App. 1921) (notes to be interpreted under the law of the place where they are payable); *Moody v. Kirkpatrick*, 234 F. Supp. 537, 540-41

(M.D. Tenn. 1964); *Bastian Bros. Co. v. Brown*, 291 N.W. 644, 646-47 (Mich. 1940) (guarantee is made at place where credit is extended and place of performance is presumed to be where lender is found); 38 C.J.S. *Guaranty* § 4 (1996) (place of performance governs, and that is presumed to be creditor's place of residence at the time the contract was made).

In short, even if the Guarantors could somehow persuade the Court that the CALIFORNIA CIVIL CODE governs the guarantees, that very Code would apply Washington law. California does not have a “strong interest and policy regarding protection of California Guarantors;” as discussed below, it has *presumptions* that can be waived without any formalities. Like the RESTATEMENT, the CALIFORNIA CIVIL CODE calls for the application of Washington law,²⁰ and Washington interprets an “unconditional guaranty” as precluding the defenses asserted by Guarantors. *Century 21 Products, Inc. v. Glacier Sales*, 129 Wn.2d 406, 413, 918 P.2d 168 (1996); *Grayson v. Platis*, 95 Wn. App. 824, 830-31, 978 P.2d 1105 (1999).

D. Judgment is Properly Entered Against Guarantors Even if California Law Applies

While Washington law is properly applied to the guarantees under Sections 194, 195 *and* 188 of the RESTATEMENT, even if one ignores the

²⁰ E.g., *Hoeckle; McNall v. Tatham*, 676 F. Supp. 987, 996-7 (C.D. Cal. 1987); *Bracker v. American National Food, Inc.*, 133 Cal. App.2d 338, 344, 284 P.2d 163 (1955).

clear guidance in Section 1646 of CALIFORNIA CIVIL CODE, Freestone is still entitled to judgment against the Guarantors under California law. By their agreements, the Guarantors waived the asserted conditions to payment.

1. **Even if California law were applied, Guarantors waived their statutory defenses by promising immediate and unconditional payment.**

In the guarantees, Abraham and Sugarman represented – in bold, capitalized type drafted by “MKA’s counsel” – that they “**UNCONDITIONALLY GUARANTEE[] THE PAYMENT OF ALL AMOUNTS DUE UNDER THIS NOTE. UPON DEFAULT OF MAKER TO TIMELY PAY ANY AMOUNT DUE HEREUNDER, LENDER MAY IMMEDIATELY DEMAND, AND THE UNDERSIGNED SHALL IMMEDIATELY PAY, SUCH PAST DUE AMOUNT.**” CP 107, 111, 115, 119, 123, 127, 131, 135, 139. The Guarantors’ duty to make *immediate payment* upon default is confirmed in the Note Extension Agreements. CP 141-142, 152-153, 163-164, 174-76. They promise to pay immediately if MKA does not.

Because Guarantors cannot reconcile the defenses they assert with their promise of unconditional and immediate payment, they embark on a discussion about Sections 2806 and 2807 of the CALIFORNIA CIVIL CODE. While it is true that sureties are deemed “liable” immediately upon default

without notice in both California and Washington, here the Guarantors promised unconditional and immediate payment to Freestone. The statutory provisions cited by the Guarantors – §§ 2845, 2849 and 2850²¹ – are gap fillers, and their operative effect is “subordinate” to the parties’ intent. *See Bloom v. Bender*, 48 Cal. 2d 793, 804, 313 P.2d 568 (1957). The California legislature specifically provided that these rights may be waived. CAL. CIV. CODE § 2856(a); *WRI Opportunity Loans II v. Cooper*, 154 Cal. App. 4th 525, 545, 65 Cal. Rptr. 3d 205 (Cal. Ct. App. 2007).

Unconditional and immediate payment is not “consistent” with the statutory provisions invoked by Guarantors. App. Brf. at 15. It is, by Guarantors’ own argument, contrary to it. As observed by the trial court:

This is a plain English statement that the lender does not have to wait for anything or take any other action before demanding full payment from the guarantor. . . .

I conclude that a guarantee that allows a lender to immediately demand payment from a guarantor must have some meaning. And it can only mean in this case that a lender is free to go look to the guarantor first, and as such, the guarantor cannot demand his rights that a lender must first collect collateral.

CP 981.

²¹ Section 2850 (which would also have been waived) applies when a surety has “hypothecated” property. The Guarantors have not hypothecated their property, and the section has no application in this case.

While Guarantors testified that they gave no thought to the law applicable to the contracts they were signing, there is no dispute that Guarantors objectively waived their right to assert “conditions” to “immediate payment,” and they are precluded from asserting Sections 2845, 2849 and 2850 (or any other law) for that purpose. It is impossible to read the guarantees any other way, and even if it were, any ambiguities in the guarantee provision are “resolved in favor of the creditor,” *Brunswick Corp. v. Hayes*, 16 Cal. App. 3d 134,138-9, 93 Cal. Rptr. 635 (Cal Ct. App. 1971), particularly here where the guarantees were, according to Abraham, “our document.” CP 1145 (Abraham Dep., 32:9-15).

California courts do not require guarantors to utter any magic words, and when a guarantor’s intent is evident, waiver may be found on “the basis of a very vague clause in the guarantee agreement.” *River Bank Am. v. Diller*, 38 Cal. App. 4th 1400, 1414-15, 45 Cal. Rptr. 2d 790 (Cal. Ct. App. 1995) (commenting on the waiver language in *Bloom*). The contract need not mention the term “waiver,” or specifically note the right or code section waived.²² Cal. Civ. Code. § 2856(b) (“[a waiver shall be

²² Legislative intent to liberalize waiver requirements is evident in the history of section 2856. Section 2856 was specifically enacted in response to *Cathay Bank v. Lee*, 14 Cal. App. 4th 1533, 18 Cal. Rptr.2d 420 (Cal. Ct. App. 1993), where the court held that a guarantor could not waive his rights without uttering specific words or phrases. *Cooper*, 154 Cal. App. 4th 525, 545 (2007) (noting the relationship between § 2856 and *Cathay*

effective without regard to the inclusion of any particular language . . . to waive any rights and defenses or any references to statutory provisions or judicial decisions); *Diller*, 38 Cal. App. 4th at 1414.

California courts have found a guarantor's unconditional guarantee of payment waives the rights asserted by Guarantors. For instance, in *Brunswick*, the court held that a guarantor waived his rights under sections 2845 and 2849 when the contract stated, "[t]his Guarantee is absolute, unconditional and continuing, and payment . . . shall be made . . . notwithstanding . . . other guarantees against which it may be entitled to resort for payment." 16 Cal. App. 3d at 138; *see also Bloom*, 48 Cal. 2d at 796. Here, Guarantors committed to the ***immediate*** and ***unconditional payment*** of the debts of MKA, a commitment which necessarily waives the "statutory conditions" that they now advocate to this Court. Given that a court applying California law would also require unconditional and immediate payment of MKA's debts, Guarantors present a false conflict that does not change the law that is properly applied in this case. By promising immediate and unconditional payment, Guarantors waived the right to delay payment. Not only is this true in California, it is the proper interpretation under Washington law, which is – as even Guarantors

Bank v. Lee).

recognize – the law governing “interpretation” of the guarantees under § 1646 of the CAL. CIV. CODE. *Century 21, supra; Grayson, supra.*

E. Guarantors’ Belated “Exoneration” Defense is Without Merit

More than two years after suit was originally filed, after an appeal and remand, in response to Freestone’s renewed motion for summary judgment, Guarantors sought leave to amend their answer to assert a new defense of “exoneration” under California law based on the Subordination Agreement that was litigated extensively in *Freestone I*. Based on its rulings on choice of law and waiver, and the evidence submitted in connection with the motion to amend, the trial court denied the motion to amend to add a defense under Section 2819 of the CALIFORNIA CIVIL CODE as futile and moot. CP 961-62. Guarantors assign error to part of this ruling,²³ arguing that there are “questions of fact” concerning whether their obligations to Freestone were exonerated by virtue of the “impairment of the creditors’ remedies against the principal without their consent.” App. Brf. at 39. Guarantors’ belated “exoneration” arguments are without merit.

²³ In their assignments and issues, Guarantors assign error to the denial of the motion to amend on grounds that it was moot, but not on the grounds that it was “futile.” App. Brf. at 4-5. By the time the trial court reached the issue of the proposed amendment, it had already selected Washington law (which made the proposed addition of § 2819 moot) and further rejected it on its merit (making it futile). Guarantors’ statement that the trial court did not consider the “merit” of its proposed defense is flatly untrue. App. Brf. at 46.

1. Guarantors have no exoneration defense under Washington law.

Citing dicta in *National Bank of Washington v. Equity Investors*, 86 Wn.2d 545, 556, 546 P.2d 440 (1976), Guarantors argue that any impairment of a guarantor's subrogation rights discharges the guarantor. App. Brf. at 39-41.²⁴ Guarantors did not seek leave to plead such a defense under Washington law,²⁵ but they are wrong on that law in any event.

²⁴ Guarantors did not assert a defense under Section 2809 of the California Civil Code, nor did they seek leave to amend to add one. As part of their "exoneration" argument, Guarantors contend that "[a] guarantor cannot have a greater obligation than the principal." App. Brf. at 43. Guarantors – who, ironically, cited *Robey v. Walton Lumber Co.*, 17 Wn.2d 242, 135 P.2d 95 (1943) in support of their argument in *Freestone I* that a guaranty is completely separate and independent of the underlying obligation – now argue that *Robey* stands for the proposition that the "liability of the principal debtor measures and limits the liability of the surety." *Id.* This is not the law, and a guarantor can agree to whatever obligations it chooses. In *Robey*, the Washington Supreme Court ruled that the guarantor was liable notwithstanding unsatisfied (and potentially unsatisfiable) conditions to action against the principal because the guarantor had given an absolute and unconditional guarantee, just as in this case. 17 Wn.2d at 259 ("respondents are not prohibited from bringing this action on the guaranty, regardless of their inability to proceed against the principal obligor"). *Robey* actually disproves Guarantors' own argument. In any event, the Note Extension Agreements require Guarantors to pay on the Notes on the stated due date, which precludes any argument that Guarantors need not perform on that date.

²⁵ In their motion to amend, Guarantors asked for leave to amend to assert "an affirmative defense pursuant to Cal. Civ. Code § 2819," CP 261, 264, 278, 956, and their argument to the trial court was not based on Washington law, which was mentioned in passing in a footnote as something that would "likely support[] the Guarantors." CP 301, n.34. Their argument was based entirely on California law, which is discussed at length at CP 299-301. The motion to amend to add a defense under § 2819 was what was specifically denied by the trial court. CP 962. It is absurd for the Guarantors to suggest that *Freestone* did not fairly oppose the motion that was brought, and their claim that they moved to add a defense under Washington law that was somehow not opposed is nonsense. It is Guarantors who did not raise, and thus waived, the arguments they are now making to this Court.

The Washington Supreme Court has since held:

While impairment of collateral generally releases a guarantor from its obligations under a guaranty agreement, ***this rule does not apply where the guaranty is unconditional.*** “The authorities agree that one who unconditionally guaranties an indebtedness is not released or discharged by virtue of ... release or impairment of ... collateral by a secured creditor.”

Century 21 Products, 129 Wn.2d at 413 (emphasis added; citations omitted); *11 R Sales, Inc. v. Yarto*, 2008 WL 4148735 at * 8 (E.D. Wash. 2008) (same).²⁶ The Guarantors’ guarantees in this case are, by their terms, unconditional or “absolute.” *Amick v. Baugh*, 66 Wn.2d 298, 303-04, 402 P.2d 342 (1965); *Robey*, 17 Wn.2d at 255-56 (separate and independent duty to pay on unconditional guarantee). Guarantors have no impairment defense under Washington law, and had they moved to amend to add one (which they did not), such a motion would have been properly rejected as futile.²⁷

²⁶ *National Bank* is cited by the Court in *Century 21*, 129 Wn.2d at 412, and it is unclear why Guarantors did not cite *Century 21* as the controlling authority in this case.

²⁷ In Guarantors’ discussion of waiver, Guarantors cite *Security State Bank v. Burk*, 100 Wn. App. 94, 100, 995 P.2d 1272 (2000) for the proposition that “the absolute nature of an unconditional guaranty does not operate as a waiver of guarantor’s defenses.” App. Brf. at 19-20. This statement is overly broad and incorrect. *Security State Bank* was based on a specific section of the Uniform Commercial Code that Division Two found to be nonwaivable. The case cannot and does not overrule *Century 21 Products*.

2. **Guarantors executed many, and reaffirmed all, of the guarantees after (and with knowledge of) the Subordination Agreement.**

On the *facts* of this case, Guarantors had no “exoneration” defense under *any* conceivable law, which likely explains why the defense was never asserted until the case had already been decided once. The Subordination Agreement was signed on February 20, 2007. While the Guarantors – the two managers of MKA and sole owners of MKA Advisors – were undoubtedly well aware of and directed its dealings with its two largest lenders, *all* of Sugarman’s guarantees and several of Abraham’s were made *after* the date of the Subordination Agreement. CP 1175 (Sugarman Dep., 50:15-18); CP 121, 129, 137 (guarantees dated April 2, 2007). As to the then-existing guarantees, Abraham expressly and repeatedly *reaffirmed* his obligation to make immediate payment to Freestone on the underlying notes more than a year after Subordination Agreement was executed, *with knowledge* of the Subordination Agreement. CP 1153 (Abraham Dep., 63:13-25) (confirming Abraham read the Subordination Agreement before signing the Note Extension Agreements). Sugarman, who received multiple copies of the Subordination Agreement *while it was being prepared in 2007*, did the same. CP 902 (¶¶ 3-7) and CP 904-913 (showing Sugarman as recipient of extensive correspondence on Subordination Agreement prior to and

after its execution). The suggestion that Guarantors did not know about and consent to (or perhaps more accurately ratify or accept) the Subordination Agreement when guaranteeing – and then reaffirming their guarantees – of immediate and unconditional payment on the due date set forth in the Notes is demonstrably false.

As to the three guarantees that were made after the date of the Subordination Agreement (including all of the guarantees by Sugarman), Guarantors' argument seems to be that their guarantees are invalid unless Freestone was in a perfected, first lien position against MKA's assets, and that anything less relieves them of liability. This is a nonsensical argument that finds no support in any of the cases or authorities cited by Guarantors. Exoneration is a California defense based on alleged impairment of subrogation rights *after* the guarantees have been made, not the lender's supposedly imperfect rights *at the time* the guarantees were made.

As to both the post-Subordination Agreement guarantees *and* the six guarantees originally made prior to the Subordination Agreement, Guarantors have no claim of impairment in any event: All of the guarantees were expressly reaffirmed and ratified by the Guarantors with knowledge of the Subordination Agreement in exchange for extensions of the due date on the Notes (and in turn the guarantees). *See* CP 145 (¶ 13).

While Guarantors argue that “knowledge alone does not establish consent,” App. Brf. at 40,²⁸ knowledge of the lender’s rights *and* an express reaffirmation of an obligation to make immediate and unconditional payment upon the principal’s default does. *See also* CAL. CIV. CODE § 1589 (“A voluntary acceptance of the benefit of a transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to be known, to the person accepting.”).

On this record, the Guarantors attempt to argue that there are “questions of fact” as to whether Sugarman “saw” the Subordination Agreement and whether Abraham “understood” it. While both arguments are legally irrelevant given the chosen law and the sequence of events, the undisputed evidence was that whether or not he now “remembers” it, Sugarman, a sophisticated business person, not only saw the Subordination Agreement before giving his guarantees, but was involved in its preparation, a fact which he did not even bother to dispute below after Freestone submitted proof that he was repeatedly copied on the

²⁸ Even this assertion is somewhat dubious. *Board of Regents of Univ. of Washington v. City of Seattle*, 108 Wn.2d 545, 553, 741 P.2d 11 (1987) (“Where a person with actual or constructive knowledge of facts induces another, by his words or conduct, to believe that he acquiesces in or ratifies a transaction, or that he will offer no opposition thereto, and that other, in reliance on such belief, alters his position, such person is estopped from repudiating the transaction to the other's prejudice. . . . Where a party knows what is occurring and would be expected to speak, if he wished to protect his interests, his acquiescence manifests his tacit consent.”).

agreement as it was being prepared.²⁹ Abraham flatly admitted he read it before explicitly reaffirming his obligations to Freestone. The Note Extension Agreements create binding, post-Subordination Agreement obligations in any event, regardless of what Guarantors claim to have known, and there is no allegation that Freestone did anything to “impair” Guarantors’ rights after that date. As such, even if California law were to apply, the Subordination Agreement does not “exonerate” or relieve Guarantors from their promise to make immediate payment upon default.

F. Even Under California Law, Guarantors Have Failed to Meet Their Burden of Proving That They Are Entitled to Relief Under Any of Their Defenses

Guarantors note that the trial court concluded there were questions of fact concerning whether the actions demanded by Guarantors were futile given MKA’s inability to pay both Gottex and Freestone. CP 982. Freestone does not challenge that ruling as a basis to affirm, but under no circumstances can judgment be entered in favor of the Guarantors.³⁰

²⁹ As proof of a “factual” question, Guarantors cite Sugarman’s deposition testimony that he was not aware of the Subordination Agreement when he gave his subsequent guarantees. Freestone subsequently submitted documentary proof that Sugarman was involved in the preparation of the Subordination Agreement, CP 904-913, along with sworn testimony that Sugarman was involved in the negotiations, CP 902, proof which he did not bother to dispute, or even address, prior to the entry of the judgments.

³⁰ Guarantors did not move for summary judgment below. Even if Guarantors were to prevail on one or more legal arguments, there are disputed or unproven factual issues on which Guarantors bear the burden of proof. On the issue of futility, Guarantors argued both that MKA had sufficient assets when Freestone filed suit but does not now (meaning it was injured by Freestone’s failure or inability to sue MKA first) and, inconsistently,

IV. CONCLUSION

After repeatedly promising to make “immediate payment” to Freestone in the event MKA failed to make timely payment on the Notes, Guarantors have now succeeded in delaying finality on their unconditional obligations for almost three years. Washington law is properly applied to the Guarantors’ payment obligations in this case, and under that law, the Guarantors’ defenses fail. Their obligation to pay Freestone is absolute and unconditional, and accrued immediately upon MKA’s default. By promising immediate payment, Guarantors waived the conditions they now assert, and there is no genuine dispute that they reaffirmed their obligations to Freestone after (and with knowledge of) the Subordination Agreement that is now cited as an impairment. Freestone is entitled to

that things are looking up, and that MKA will have sufficient assets to pay Freestone in the future (which, given Guarantors’ subrogation rights, defeats their claim of prejudice). Section 2845 of the California Civil Code states that “if the creditor neglects to [proceed against the principal], the surety is exonerated *to the extent to which the surety is thereby prejudiced.*” (Emphasis added.) This section envisions a scenario in which the creditor does not pursue the principal. Similarly, Section 2849 provides that a surety is “entitled to the benefit of every security for the performance of the principal obligation.” This section means that guarantors are “subrogated to the rights and security formerly held by the creditor.” *Western Security Bank v. Superior Court*, 15 Cal.4th 232, 248, 933 P.2d 507 (1997). Neither section is a bar to suit, and would at most support a claim of offset if one could be proved. On their claim of exoneration under Section 2819, Guarantors argue that there are “questions of fact” as to whether they consented to the Subordination Agreement. Moreover, Section 2819 provides for exoneration “except so far as [guarantor] is indemnified by the principal.”

immediate payment, and the judgments entered in its favor are properly affirmed.

RESPECTFULLY SUBMITTED this 6th day of April, 2011.

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CERTIFICATE OF SERVICE

I certify and declare that on the 6th day of April, 2011, I caused to be served by legal messenger and U.S. mail service the foregoing Brief of Respondents on the following parties at the following addresses:

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