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No. 66301-1-I

COURT OF APPEALS, DIVISION 1

OF THE STATE OF WASHINGTON

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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.

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**OPENING BRIEF OF APPELLANTS  
MICHAEL ABRAHAM AND JASON SUGARMAN**

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NOTE

The guarantors filed a *Compendium of Authorities* with the trial court which is found at CP 530-853 and contains California statutes, the Restatements, Treatises and extra-jurisdictional case law including multiple California cases. The index to the compendium is found at CP 530-32.

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## I. INTRODUCTION

This Court should reverse for legal error the \$30,477,700 in summary judgments in favor of a group of lenders against personal guarantors Michael Abraham and Jason Sugarman. These California guarantors were entitled to assert California defenses. The trial court deprived them of these defenses based on an erroneous conflict of laws analysis. The trial court's two alternative grounds are both wrong. The trial court first erred when it held no conflict of laws exists because the guarantors expressed in the guarantees their intent to waive the California law. This is an erroneous construction of the guarantees. On *de novo* review this Court should conclude the guarantees do not express waiver.

Second, the trial court reached the wrong result under its alternative conflict of laws analysis, also reviewed *de novo*. California law, not Washington, applies to the issue whether these California guarantors were entitled to assert California's statutory protections for guarantors. California had the more important contacts with the guarantee transaction and the greater interest in the issue of what protections are afforded its guarantors. California is so interested in protecting guarantors' rights that in 1939 it enacted a statute allowing guarantors to demand that creditors first pursue the principal and collateral. Pursuant to the Restatement (Second) of Conflict of Laws followed in Washington

applicable to guarantees, California law applies because California has the most significant relationship to the transaction and the parties for the particular issue of a guarantor's defenses. Under California law, the trial court should have denied the lenders' motion for summary judgment because it is uncontested the lenders have not pursued the principal or collateral despite demand.

This Court should reverse because summary judgment was precluded by the guarantors' exoneration argument. The undisputed evidence, under both California and Washington law, required the guarantors be exonerated by the lenders' agreement to subordinate their loans to senior creditor Gottex and by their covenants not to collect their debts from the principal and collateral until Gottex was fully paid. The guarantors never consented to this; their liability is discharged.

This Court should reverse for legal error.

## **II. ASSIGNMENTS OF ERROR**

1. The trial court erred in granting summary judgment against Sugarman and Abraham.
2. The trial court erred in concluding that there was no conflict between California and Washington laws on the basis that the guarantors expressed in the guarantees an intent to waive the protections of California law.
3. The trial court erred in concluding that, if there were a conflict, Washington law instead of California law applied to the issue of what protections apply to the guarantors and

whether the guarantors could require the lenders first to pursue the principal and collateral.

4. The trial court erred in granting summary judgment when the evidence presented a question of fact under both California and Washington law whether the guarantors' were exonerated by the lenders' agreement with the principal (to which the guarantors were not a party) not to pursue the principal or collateral until a senior lender was paid.
5. The trial court erred in denying as moot the motion to amend the answer.

### **III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR**

1. Was it legal error to construe the guarantees to contain an expression of intent to waive the protections of California law in the absence of any waiver language? (Assignments of Error 1 and 2).
2. Was it legal error to apply Washington law despite the more significant relationship of California to the parties and the transaction with respect to the particular issue of a guarantors' defenses when the guarantors were located in California, signed the guarantees in California, and had the expectation that the protections of California law would be available, and where the principal and assets are located in California, the investment concerned the development of California real estate, and California has the stronger policy interests? (Assignments of Error 1 and 3).
3. Was it legal error to grant summary judgment when the evidence presented a question of fact under both Washington and California law whether the lenders exonerated the guarantors by entering a contract with the principal and a third party, without the consent of the guarantors, to forestall collection against the principal and collateral until the third party was fully paid? Can the lenders enforce greater obligations against the guarantors than the principal absent consent? (Assignments of Error 1 and 4).

4. Was it error to deny the motion to amend as moot? (Assignment of Error 5).

#### IV. STATEMENT OF THE CASE

The California guarantors seek relief from the trial court's erroneous grant of summary judgment appealing the monetary judgments against them. CP 1047-1133. The trial court entered judgments against Mr. Abraham in principal amounts totaling \$30,477,700. CP 967 (order on summary judgment); *see also* CP 985-98, 999-1006, 1007-14, 1015-22, 1023-30, 1031-38, 1039-46 (judgments). The trial court entered judgments against Mr. Sugarman totaling \$6,926,750. CP 968 (order on summary judgment); *see also* CP 1023-30, 1031-38, 1039-46 (judgments).

##### A. **Washington Lenders Loaned Money to Invest in a California Principal's Financing of California Projects, and Requested Personal Guarantees from California Residents Sugarman and Abraham.**

The guarantors reside and work in California. CP 379, p. 5; 404, ¶ 1; CP 391, p. 5; CP 407, ¶¶ 1, 5. They are the principals of MKA, a California limited liability company established in 1988 with offices in Newport Beach, California. CP 404, ¶ 1; CP 407, ¶ 2. MKA provides capital to primarily California developers for land development. CP 353, ¶ 3; 407-8, ¶¶ 2-4. The capital comes primarily from investors. *Id.* MKA manages investments from institutional and accredited individual investors through investment funds. *Id.* Through those funds, MKA provides debt

financing to real estate developers based primarily in California. *Id.* The loans to developers are typically secured by deed of trust on the real property under development. *Id.* The proceeds of the lenders' loans were used to finance California developers. CP 408, ¶ 8. The loans were secured primarily by the California real property under finance and assets of MKA located in California. CP 428, ¶ 11; CP 437, ¶ 1; CP 441-42, § II.

The Freestone lenders pursued investment opportunities with MKA in California. The lenders learned about MKA through a third party located in California. CP 408, ¶ 6; CP 96, ¶ 12. The lenders contacted MKA in California. CP 408, ¶ 7. Representatives of the lenders visited MKA in California and viewed collateral properties "probably a dozen times." CP 408, ¶ 7; CP 401 69:17-23; CP 396 22:20-21. *See also* CP 394 15:3-4 (Sugarman testified: "Freestone came to MKA's office so many times to go through our portfolios."). The lenders sent their money to MKA in California. During 2006 and 2007, MKA executed nine promissory notes with individual lenders. CP 98-99, ¶¶ 21(a)-(i); CP 105-139 (the nine notes). Of the nine notes, two were signed 5/8/06, three were signed 10/30/06, one was signed 2/1/07, and three were signed 4/2/07. *Id.* Each note was accompanied by a security agreement, securing the note by MKA's assets in California. CP 100-01, ¶ 21(p); *see, e.g.*, CP 195-200.

The notes selected Washington law at the lenders' request for tax purposes. CP 420, lines 17-22.

The lenders asked MKA employees to have Abraham and/or Sugarman, whom the lenders knew to be located in California, guarantee the notes. CP 383 33:2-9; CP 395 20:16 to 21:23. The lenders made no personal request to the guarantors. *Id.* The guarantees were drafted in California. CP 97-98, ¶¶ 19-20. The lenders never discussed the guarantees with the guarantors, nor negotiated their terms. CP 383 33:2-9; CP 395 20:13-21:23. The guarantors were unrepresented by counsel. CP 380 13:13-17; 381 14:4-5; 384 46:9-14; 393 13:2-5. Abraham guaranteed payment on all of the notes and Sugarman guaranteed payment on the three notes signed 4/2/07. CP 107 (Abraham); CP 111 (Abraham); CP 115 (Abraham); CP 119 (Abraham); CP 123 (both); CP 127 (Abraham); CP 131 (both); CP 135 (Abraham); CP 139 (both) (the guarantees). The guarantors executed the guarantees in California. CP 353, ¶ 4.

Both guarantors were familiar with guarantees from their dealings in California. CP 386 75:12-78:13; CP 398 42:4-5. Abraham testified his understanding was that the lenders would have to proceed against the security interests before enforcing the guarantees. CP 386 75:12-78:13. He testified that as guarantor he would personally "step up" "if the asset hasn't paid the debt." *Id.* He explained, "[F]irst what we do, we look to the

asset first to pay the debt. If the asset hasn't paid the debt, then we go to the guarantes." *Id.* He confirmed he understood the guaranty to require "exhaustion of the collateral" before he was obligated to perform. *Id.* He further explained his understanding came from past experience enforcing guarantes, including with MKA and local banks. *Id.*

The guarantes are short. Each one states:

THE UNDERSIGNED HEREBY UNCONDITIONALLY GUARANTIES 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.

**B. Without Consent by the Guarantors, The Lenders Subordinated Their Loans to a Senior Creditor and Covenanted Not to Sue the Principal or Pursue Collateral.**

The lenders entered into a subordination agreement (the "Subordination Agreement") with senior creditor Gottex and MKA on February 20, 2007 (CP 354-55, ¶ 9; CP 366-71). The lenders covenanted not to pursue MKA for collection or payment of amounts due it until Gottex was fully paid. CP 366-67 at ¶¶ 2, 4. The lenders had broad security interests "in substantially all of MKA's assets." CP 428, ¶ 11; CP 441-42. In the Subordination Agreement they covenanted not to pursue

this collateral until Gottex was fully paid. CP 367 at ¶ 6. The Subordination Agreement is binding on successors. CP 369 at ¶ 14.

The guarantors are not parties to the Subordination Agreement. The lenders offered no evidence of the guarantors' express consent to the Subordination Agreement. The lenders offered disputed evidence whether and when the guarantors even had knowledge of the agreement, discussed below. The lenders offered no evidence that the guarantors understood that while the Subordination Agreement prevented enforcement against MKA until Gottex was paid, they would not receive the same treatment.

Sugarman disputes knowing about or consenting to the Subordination Agreement at any time relevant to this dispute. CP 399 at 49:5-25. Abraham also does not admit consent to the agreement. Abraham admitted that when he later signed note extension agreements in 2008, he had read the Subordination Agreement. CP 934 63:13-25. He also testified that his understanding of the agreement was that "there would be no actions on anybody's part until after [Gottex] was paid." CP 934, 63:1-5. Abraham never testified that he understood and agreed that pursuant to the Subordination Agreement the lenders could pursue him but not MKA.

Neither the note extension agreements (CP 945-54) nor any written document signed by the guarantors refer to the Subordination Agreement at all. The note extension agreements contain an integration clause stating

that all understandings are stated in the document. CP 950 at ¶ 15. While the Subordination Agreement required the lenders to mark future notes as subject the agreement (CP 367-68 at ¶ 5), the lenders failed to do so.

**C. On the Principal's Default, the Lenders Sued the Guarantors, Resulting in a First Set of Summary Judgments That Were Reversed and Remanded for a Conflict of Laws Analysis.**

MKA was unable to pay the lenders on their notes while paying Gottex. CP 101, ¶¶ 23-24. The lenders initiated this lawsuit on September 2, 2008. CP 1-38. In their complaint, the lenders requested a declaration that MKA was in default, but no judgment or collateral. CP 22-23 ("First Cause of Action"). This is because the lenders had subrogated their loans to the senior creditor and could not collect against MKA without breaching the Subrogation Agreement. The lenders sought money judgments only against the Guarantors on the guarantees. CP 23-25 ("Second Cause of Action"). It is undisputed that the lenders have not pursued the principal or collateral. CP 508, ¶¶ 2-3; CP 354, ¶ 8.

The trial court granted the lenders' first summary judgment motion based on Washington law in March 2009. *See Freestone Capital Partners, LP v. MKA Real Estate Opportunity Fund I, LLC*, 155 Wn. App. 643, 230 P.3d 625, 2010 Wash. App. LEXIS 855 (Wash. Ct. App. Apr. 26, 2010) (in the record at CP 305-345) ("*Freestone v. MKA*"). This Court reversed

the judgments, ruling that the parties had not selected the law to be applied to the guarantees. *Id.* at 658-63. This Court instructed the trial court on remand to conduct a conflict of laws analysis to determine whether a conflict existed in light of the lenders' waiver argument, and whether California or Washington law controlled the guarantors' ability to assert defenses to the action. *Id.* at 663-68. This Court explained Washington's conflict of laws analysis applicable to guaranty contracts. *Id.*

**D. The Trial Court Again Granted Summary Judgment to the Lenders on Two Alternative Grounds**

After the mandate issued, the lenders again moved for summary judgment urging Washington law be applied and that no conflict of laws existed because the guarantors had waived their statutory protections in the guarantees. CP 210-36. The guarantors opposed the relief requested, urging California law be applied, CP 280-303, and rebutting waiver. CP 288-91, § C. The guarantors argued that under California or Washington law, they were exonerated by the lenders' entry into the Subordination Agreement with MKA and Gottex. CP 284; CP 299-301; CP 301 note 34. Finally, the guarantors factually disputed the lenders' argument that, even if the California defenses applied, pursuit of the principal and collateral was futile due to insufficient assets. CP 302-303; 347-348, ¶¶ 3-4; CP 508, ¶ 4. The guarantors also argued that any alleged futility was caused by the

lenders' delay in failing timely to pursue the principal and collateral upon the guarantors' demand, resulting in the guarantors' exoneration. CP 301-302, § G; CP 353-54, ¶¶ 6-7.

The trial court granted summary judgment to the lenders. CP 963-84, and incorporated into its written order the transcript of its decision and reasoning. CP 967 at lines 3-7; CP 971-84 (transcript attached to order). The Court ruled in the alternative: 1) no conflict of law exists because the guarantors waived the protections of California law in the guarantees (CP 978, line 11 to CP 981, line 19), and 2) if their rights were not waived, the Restatement Conflict of Laws favors application of Washington law. CP 972, line 7 to 978, line 8.

The trial court found material issues of disputed fact regarding the alleged futility of pursuit of the principal and collateral. CP 1068 line 20 to 1069 line 2.

Finally, the trial court denied as moot the guarantors motion to amend their answer to clarify their exoneration defense. CP 961-62. CP 962 (motion is denied "as futile and moot").

## **V. ARGUMENT**

This Court should reverse on *de novo* review of the conflict of laws analysis. First, the trial court erred by finding that no conflict of laws exists due to waiver of the California protections expressed in the

guarantees. Both California and Washington law support rejection of this construction based on insufficient expression of intent to waive in the guarantees. Second, the trial court erred when it concluded that Washington law applies. The trial court's conflict of law analysis failed to focus on the exact issue before it: which state had the more significant relationship *to the particular issue* whether the guarantors are entitled to assert defenses codified in California. Instead, the trial court considered the transactions generally, focusing on the underlying loan transaction between MKA and the lenders. It failed to recognize that the guarantors' location in California is the most important contact for the issue of the guarantees. The trial court disregarded relevant Washington precedent, disregarded the justified expectations of the guarantors, and disregarded the relevant policies of each state. This contravenes the required Restatement analysis. A proper analysis results in the application of California law to the issue of the guarantors' defenses.

**A. Standards of Review.**

Interpretation of a written contract is a matter of law. *Fancher Cattle Co. v. Cascade Packing*, 26 Wn. App. 407, 409, 613 P.2d 178 (1980). Which state's laws apply is a question of law reviewed *de novo*. *McKee v. AT&T Corp.*, 164 Wn.2d 372, 384, 191 P.3d 845 (2008). *De novo* review applies to all matters of law. *Wilson Court Ltd. P'ship v. Tony*

*Maroni's*, 134 Wn.2d 692, 698, 952 P.2d 590 (1998). All facts and reasonable inferences are considered in a light most favorable to the nonmoving party. *Id.* Dismissal of defenses on summary judgment is reviewed *de novo*. *Freestone v. MKA*, 155 Wn. App. at 672.

This Court substitutes its judgment for that of the trial court on *de novo* review. *Skamania County v. Columbia River Gorge Comm'n*, 144 Wn.2d 30, 42, 26 P.3d 241 (2001). *Sunnyside Valley Irrigation Dist. v. Dickie*, 149 Wn.2d 873, 880, 73 P.3d 369 (2003). In applying these standards, this Court should reverse and vacate the judgments.

Motions to amend are freely granted. CR 15(a). The standard of review when a request to amend a pleading is denied is a manifest abuse of discretion or a failure to exercise discretion. *Herron v. Tribune Pub'g Co.*, 108 Wn.2d 162, 165, 736 P.2d 249 (1987); *Caruso v. Local Union No. 690 of Int'l Bhd. of Teamsters, Etc.*, 100 Wn.2d 343, 351, 670 P.2d 240 (1983) (allowing amendment five years four months after the original complaint was filed upon a finding of no prejudice to the opposing party).

**B. Because The Guarantees Contain No Expression of Waiver, The Trial Court Erred in Concluding That No Conflict of Laws Exists.**

The trial court erroneously ruled that the guarantees demonstrate intent by the guarantors to waive their rights under the California statutes. (CP 978, line 11 to CP 981, line 19). If waiver were present, no conflict of

laws exists. Waiver is not present. The trial court's construction is an error of law and should be reversed on *de novo* review.

Absent a choice of law provision, Washington conflict of law analysis first requires a determination if an actual conflict exists.<sup>1</sup> Here, conflict exists. Washington common law allows the lenders to proceed against the guarantors directly without first proceeding against the principal. *Warren v. Washington Trust Bank*, 92 Wn.2d 381, 390 n.1, 598 P.2d 701 (1979). In contrast, § 2845 of the California Civil Code grants guarantors the right to demand that creditors first “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.” *See 1 Witkin Sum. Cal. Law Contracts*, § 1003; *Freestone v. MKA*, *supra*, 155 Wn. App. at 663-64. The guarantor is entitled to the “benefit of every security for the performance of the principal obligation. . . .” Section 2849. The lenders have not proceeded against the principal or the security despite demand. This defeats collection against the guarantors.

This Court should find a conflict of laws. The trial court erred in construing the guarantees to contain an expression of waiver. The trial court lost sight of the inquiry—whether waiver language is present, i.e., an

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<sup>1</sup> *See Freestone v. MKA*, *supra*, 155 Wn. App. at 665; *Potlatch No. 1 Federal Credit Union v. Kennedy*, 76 Wn.2d 806, 809, 459 P.2d 32 (1969); *Granite*

expression of intent to knowingly waive rights—and instead merely construed the language in the guarantee. Reversal is necessary.

**1. The plain language of the guarantees refutes the trial court’s ruling finding waiver.**

The trial court’s finding of waiver is inimical to the California statutory scheme. Guarantors obligated “immediately” on guarantees maintain the right to invoke the protections of § 2845. The right is *statutorily* prescribed even if not present in the written guarantee. Section 2807 provides that a guarantor is liable “immediately upon the default of the principal, and without demand or notice.” Notwithstanding this language, the Code goes on at § 2845 to permit the guarantor to require the creditor to proceed against the principal or collateral. A guarantee which is “unconditional” or requires “immediate payment,” is consistent with the guarantors’ continued right to assert the protections of the Code. Such words in no way preclude or waive application of § 2845, § 2849 or § 2850. Guarantees are presumed unconditional under § 2806.<sup>2</sup> Yet § 2806 and § 2807 coexist with §§ 2845, 2849, and 2850. The unconditional, immediate nature of a guaranty does not abrogate the coexistent defenses.

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*Equip. Leasing Corp. v. Hutton*, 84 Wn.2d 320, 324, 525 P.2d 223 (1974); *Mulcahy v. Farmers Ins. Co.*, 152 Wn.2d 92, 101, 95 P.3d 313 (2004).

<sup>2</sup> “A suretyship obligation is to be deemed unconditional unless its terms import some condition precedent to the liability of the surety.”

California enacted legislation in 1939 to protect guarantors the same as sureties, *American Guaranty Corp. v. Stoody*, 230 Cal. App. 2d 390, 392 (Cal. App. 2d Dist. 1964), citing Cal. Civ. Code § 2787. This entitled guarantors to protections previously 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. A large body of California law enforces these policy choices and negates the lenders' waiver theory. The statutory protection was created to guard against *precisely the type of guarantee at issue here*: one that would not, on its face, permit a guarantor to demand that the lender first look to the principal and the collateral.

*Moffett v. Miller*, 119 Cal. App. 2d 712, 713-14 (1953), describes this statutory scheme. 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. *Id.* See also *State Athletic Comm'n of Calif. v. Mass. Bonding and Ins. Co.*, 46 Cal. App. 2d 823, 829 (1941) (the purpose of the equitable code sections are not at odds with an unconditional guaranty but offer unique equitable protections for California guarantors). *Moffett* describes the precise situation here. After

1939, a guarantor of an unconditional guaranty providing for “immediate liability” may invoke § 2845. The trial court’s ruling misapplies California law, including *Moffett* and *State Athletic Comm’n*.

The trial court also failed to identify any intent to waive the statutory protections in the language of the guarantees. California law requires an express waiver. Cal. Civ. Code § 2856. *See also Krueger v. Bank of America*, 145 Cal. App. 3d 204, 213 (1983) (rights under § 2845 “may be expressly waived”). The California Civil Code does not prescribe waiver language, but it does offer “safe harbor” language that can be used to unequivocally express waiver. *See* Cal. Civ. Code § 2856(c)(1).<sup>3</sup> The guarantees do not contain the safe harbor language.

Guarantees are interpreted by the same rules as other types of contracts, with a view towards effectuating the purposes for which the contract was designed.<sup>4</sup> The California Supreme Court in *Bloom* stated that “carrying out the expressed intent of the parties’ accords with the

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<sup>3</sup> “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.”

<sup>4</sup> *Bloom v. Bender*, 48 Cal. 2d 793, 803, 313 P.2d 568 (1957). *See also Home Fed. Sav. & Loan Ass’n v. Ramos*, 229 Cal. App. 3d 1609, 1613, 284 Cal. Rptr. 1 (1991) (A guaranty must be interpreted “consistent with the *expressed* intent of the parties under an *objective* standard.”). No

basic rules of suretyship law. . . .” *Id.* To establish knowing waiver, the language must “adequately express such a waiver.” *River Bank Am. v. Diller*, 38 Cal. App. 4th 1400, 1417 (Cal. App. 1<sup>st</sup> Dist. 1995). In both *Stoody* and *Cooper*, two cases where waiver was found, the parties used the word “waive.”<sup>5</sup> These guarantees contain no like expression.<sup>6</sup> No intent to waive the Guarantors’ rights to §§ 2845, 2849, or 2850 can be found in the guarantees.

The lenders argued waiver based on California law. *See* CP 226-228. California has a statute for choice of law in contract construction that suggests that Washington law might control because the guarantors make payment to Washington. *See* Cal. Civ. Code § 1646 (“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

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reasonable guarantor would consider these guarantees to waive provisions of the California Civil Code.

<sup>5</sup> *American Guaranty Corp. v. Stoody*, *supra*, 230 Cal. App. 2d at 394 (italics added by court). *See also WRI Opportunity Loans II, LLC v. Cooper*, 154 Cal. App. 4<sup>th</sup> 525, 542 (Cal. App. 2d Dist. 2007) (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.”). *See also Brunswick Corp. v. Hays*, 16 Cal. App. 3d 134, 138 (Cal. App. 2d Dist. 1971) (“notwithstanding” expressed intent to waive).

<sup>6</sup> There is no extrinsic evidence supporting any intent to waive rights. To the contrary, Mr. Sugarman testified explicitly that he never intended to waive any rights within the guarantees, stating, “I didn’t waive any rights

the law and usage of the place where it is made.”). The guarantees do not express waiver under Washington law either.

Under Washington law the guarantees would be construed as under California law because they lack expression of an intent to waive rights. *See Colo. Structures, Inc. v. Ins. Co. of the W.*, 161 Wn.2d 577, 588, 167 P.3d 1125 (2007) (“A contract, including a bond, should be construed as a whole. . . . [I]t should be construed in accordance with the parties' plain intent.”); *Hearst Commc'ns, Inc. v. Seattle Times*, 154 Wn.2d 493, 503-04, 115 P.3d 262 (2005) (contracts must be construed according to objective manifestations). Guarantees are to be construed “without reading into it terms and conditions on which it is completely silent.” *Nat'l Bank of Wash. v. Equity Investors*, 81 Wn.2d 886, 918, 506 P.2d 20 (1973) (emphasis added). The guarantees are silent on waiver, containing no objective manifestation of an intent to waive rights.

Under Washington law, the absolute nature of an unconditional guaranty does not operate as a waiver of a guarantor's defenses. *See Security State Bank v. Burk*, 100 Wn. App. 94, 100, 995 P.2d 1272 (2000) (a guarantor's unconditional guaranty did not encompass a waiver of the requirement to dispose of collateral in a commercially reasonable fashion),

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as a guarantor in this agreement or any other agreement.” *Sugarman Dep.*, 41:1-2.

citing *United States v. Willis*, 593 F.2d 247, 254 (6<sup>th</sup> Cir. 1979). In *Willis*, the Court rejected the argument that the guarantor waived the defense of commercial reasonableness simply by virtue of the fact that guaranty was “unconditional.” *Id.* The *Willis* court acknowledged the argument’s “superficial appeal,” but the court went on to conclude that use of the term did not express waiver and the defense of the doctrine of commercial good faith remained available to the guarantor *Id.* at 255. A guarantor’s waiver of a defense requires a manifestation of specific intent to do so. *See, e.g., Fruehauf Trailer Co. of Canada, Ltd. v. Chandler*, 67 Wn.2d 704, 709, 409 P.2d 651 (1996) (the guaranty at issue waived a defense in “clear and unambiguous terms.”).

No terms in the short guarantees express waiver under either California or Washington law.

**2. Analysis of the trial court’s oral ruling illustrates the trial court’s missteps.**

The errors in the trial court’s reasoning are revealed in its oral decision. The court characterized the decision whether the guarantors waived their California defenses as a “close call.” CP 981, line 10. It is not. Either the guarantors expressed waiver or they did not. The trial court correctly noted that no waiver language is present in the guarantees. CP 981, lines 24-3 (“The guarantee does not contain any language indicating a

waiver of rights. It certainly does not contain the safe harbor language . . . .”). This should have been the end of the inquiry.

The trial court next identified Cal. Civ. Code § 2856(3)(b) as a relevant statute, noting that no particular language or phrase is necessary to establish waiver so long as the contractual provision “expresses an intent to waive any or all of the rights and defenses” available under the Code. CP 981, lines 4-9. The trial court then misstepped, concluding that because the guarantee contains the words “*immediately* demand payment from a guarantor,” “it could only mean that lender is free to look to the guarantor first, and as such, the guarantor cannot demand his rights that a lender must first collect collateral.” CP 981, lines 10-16 (emphasis added). The trial court disregarded California law to conclude that was an expression of waiver. CP 1068.

The trial court never seized on or found any language alternative to the word “waive” that expressed the same idea. The trial court instead merely construed the language as if this were a pre-1939 California case. This is a post-1939 case and the statutory scheme does not equate that language to waiver. The trial court did exactly what California does not allow. It prevented a guarantor from asserting the rights of the statute absent an expression of waiver. This Court should reverse the trial court’s

ruling that the guarantors waived their statutory protections. A conflict of laws exists; a proper conflict analysis is necessary.

**C. The Trial Court Erred in Its Alternative Conflict of Laws Analysis When It Applied Washington Law to the Guarantees.**

The trial court failed to recognize California’s more significant relationship to the guarantee transactions and to the issue of a guarantor’s available defenses. On *de novo* review, this Court should hold that California law applies. This Court should reverse.

If a conflict of laws exists, Washington courts apply the law of the state with *the most significant relationship* to the contract pursuant to Restatement (Second) of Conflict of Laws § 6 (“§ 6”)<sup>7</sup> and Restatement (Second) of Conflict of Laws § 188 (“§ 188”).<sup>8</sup> *Potlatch, supra; Freestone v. MKA*, 155 Wn. App. at 665-66. “The most significant relationship rule has been specifically extended to contracts of suretyship or guaranty.”

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<sup>7</sup> The § 6 comments guard against precise rules where the difficulties and complexities involved require consideration of the underlying factors in the situation at issue. § 6, Cmt. on Subsection 2 at (c). § 6 comments urge a court to “give consideration not only to its own relevant policies . . . but also to the relevant policies of all other interested states” to reach a result that “will achieve the best possible accommodation” of all the states’ policies. *Id.* at (f). The court should consider the justified expectations of the parties. *Id.* See full text in appendices.

<sup>8</sup> The Restatement (Second) of Conflict of Laws § 188 summarizes the factors that a court should consider in determining which state has the most significant relationship with the contracts in the absence of an effective choice of law. See full text in appendices.

*Freestone v. MKA*, at 665-66, citing *Granite Equip. Leasing Corp.*, 84 Wn.2d at 324.

§ 188(2) summarizes five contacts which “are to be evaluated according to their relative importance with respect to the particular issue.” § 188.<sup>9</sup> In the first appeal, this Court instructed that the most significant relationship test and factors set forth in § 188 determine the law applicable to suretyship contracts. *Freestone v. MKA*, at 666. This Court found this to be true even considering § 194.<sup>10</sup> This Court noted, where “the initial clauses of § 194 suggest that the choice of Washington law in the MKA promissory notes determines the law to be applied to the guarantees,” the later comments in § 194 are consistent with the Washington Supreme Court’s view expressed in *Potlatch* that “normally the factors of § 188 determine the law applicable to surety contracts.” *Id.* at 666. This Court noted the provisions in § 194 calling for another state’s local law if “with

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<sup>9</sup> See also *G. W. Equip. Leasing Inc. v. Mt. McKinley Fence Co.*, 97 Wn. App. 191, 195-96, 982 P.2d 114 (1999) (“some contacts are more significant than others”), citing *Potlatch*, 76 Wn.2d at 810 (“application of [the significant relationship] principle does not involve merely counting the contacts. Rather these contacts are guidelines indicating where the interests of particular states may touch the transaction in question”).

<sup>10</sup> § 194 provides that, where the parties do not select the law in a guaranty contract, the rights created are determined by the local law of the state where the contract requires repayment “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.”

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.” *Id.* at 666-67, citing § 194. The Court noted that comments to § 194 reiterate that, “[o]n occasion, a state which is not the state whose local law governs the principal obligation will nevertheless, with respect to a particular issue, be the state of most significant relationship to the suretyship contract and the parties and hence the state of the applicable law.” *Id.* at 667, citing comments to § 194. The trial court correctly noted that the fact that payments were due in Seattle is a contact that is “not determinative.” CP 974, lines 12-14. Application of the most significant relationship test is necessary.

**1. California Has the Most Significant Relationship to the Issue of What Protections Are Due the Guarantors.**

Analysis under § 6, § 188 and § 194 of the Restatement strongly supports application of California law to the issue at hand.

§ 6 sets out the broad principles of conflict of laws, and requires courts to give consideration “to the relevant policies of all other interested states” to reach a result that “will achieve the best possible accommodation” of all the states’ policies. Here, consideration of California’s policies demonstrates that application of California law is necessary for that optimal accommodation. This Court’s considerations

should include the relevant policies of the forum, the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue, and the protection of justified expectations. Rest. (Second) Conflict of Laws, § 6. These factors establish that California has the most significant relationship to the guarantors.

“State interest analysis focuses on whether application of the state’s law under the circumstances of the particular case will advance policies that the law was intending to promote.” *Business Loan Center, LLC v. Nischal*, 331 F. Supp. 2d 301, 309 (2004). California’s strong interest in and policy regarding protection of California Guarantors is clear and reflected in California statutes. Since 1939, California has consistently protected guarantors through this statutory scheme that includes § 2845, § 2849, and § 2850. In *State Athletic Comm’n of Calif.*, 46 Cal. App. 2d at 829, the court described the policy behind the implementation of Cal. Civ. Code §§ 2845 and 2849: “These code sections are the enactment of rules developed in equity to give relief from the common law doctrine which permitted the creditor to enforce remedies against the surety without reference to his rights against the principal.”

Application of California law advances the policy that the California statutes were enacted to promote, protection of California guarantors. Washington does not have the same level of interest in the

issue. The legislature has remained silent in this area of law. Washington has a more general interest in this transaction of ensuring that contracts are enforced, but no precise policy interest in the treatment of guarantors.

The consideration of justified expectations favors application of California law. The record is uncontested that the guarantors, who were not advised by counsel in these transactions (CP 380 13:13-17; 381 14:4-5; 384 46:9-14; 393 13:2-5), were familiar with how guarantees in California operated, including the requirement that the principal and collateral first be exhausted. CP 386 75:12-78:13; CP 398 42:4-5. This knowledge reasonably formed their expectation as to how the guarantees in question would operate. This is not a case where *Washington* guarantors are attempting to assert California law for a transaction that concerns participants in both states. They are *California* guarantors, precisely the persons the California legislature has acted to protect. The considerations of § 6 support application of California law to this issue.

Analysis under § 188 compels the same conclusion. The contacts of § 188 “are to be evaluated according to their relative importance with respect to the particular issue.” § 188. *See also G. W. Equip. Leasing Inc. v. Mt. McKinley Fence Co., supra*, 97 Wn. App. 191 at 195-96 (“some contacts are more significant than others”). “[A]pplication of [the significant relationship] principle does not involve merely counting the

contacts. Rather these contacts are guidelines indicating where the interests of particular states may touch the transaction in question.” *Potlatch*, 76 Wn.2d at 810.

The contact most important to the issue of the guarantors’ defenses is the location of the guarantors. They are located in California, they received the lenders’ request for guarantees in California, and they executed the guarantees in California.

**a. Place of contracting and negotiation support application of California law.**

California has the most significant relationship to the guarantees, as both the place of contracting and place of negotiation occurred in California.

“[T]he 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. . . .” § 188 comment (e). In *Granite Equip. Leasing, supra*, the place of contracting was found to be the place where the guaranty was signed. 84 Wn.2d at 325.<sup>11</sup> This Court should follow this Washington choice of law case concerning guarantees. Here, the

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<sup>11</sup> See also *Wilson Court Ltd. P’shp v. Tony Maroni’s, Inc., supra*, 134 Wn.2d at 710, 952 P.2d 590 (1998) (“A contract of guaranty, like every other contract is made by the mutual assent of the parties. When the contract is signed by the guarantor at the other party's request, mutual assent is proved.”).

guarantors accepted the terms of the guarantee when they signed them in California, as the trial court correctly concluded. CP 974. The parties agree there was no negotiation of the terms and that Abraham and Sugarman, located in California, never discussed the guarantees with the lenders. CP 383 33:2-9; CP 395 20:13-21:23. These contacts weigh in favor of California law.

**b. Subject matter and place of performance are neutral contacts not significant to the guarantors' defenses.**

The subject matter and place of performance are not decisive contacts for guarantees under Washington case law. The place where a guaranteed debt is to be paid can represent the subject matter of the contract. *See Granite Equip. Leasing*, 84 Wn.2d at 325. In *Granite Equip. Leasing*, the Court applied Washington law to a guaranty and the issue of available defenses even though the place of performance of the guaranty and its subject matter were New York. *Id.* at 324-27. The Court applied Washington law notwithstanding that the underlying lease selected New York law. *Id.*

These documents are silent. The debtor mailed or transferred payment to Washington. This contact does not significantly favor the lenders because payment is not a significant contact in the context of the issue of the Guarantors' protections. The debtor could have sent payment

to a creditor located *anywhere* without a material change to the guarantors' expectations and California's interest in protecting guarantors.

**c. The guarantors' domicile in California is the most important contact.**

The factors related to location of the parties favor application of California law. The most important domicile in relation to the issue of the guarantors' defenses is the guarantors' domicile. Abraham and Sugarman are domiciled in California. MKA is a California limited liability company. In contrast, three of the four plaintiff entities are Delaware limited partnerships. Only Freestone Capital Partners L.P. is a Washington limited partnership. While the entities' place of business is primarily Washington, Freestone also operates in Santa Barbara, California. When it applied Washington law to the guaranty at issue in *Granite Equip. Leasing*, the Supreme Court noted that while the creditor was located in New York, it also had offices in Washington. *Granite Equip. Leasing*, 84 Wn.2d at 325. The location of the creditor is not significant to the issue of the guarantor's defenses, while the guarantors' domicile is the most important contact.

The creditor's location is not determinative to the defenses an obligor can assert, as illustrated in *Pacific Gamble Robinson Co. v. Lapp*, 95 Wn.2d 341, 348, 622 P.2d 850 (1980). The court applied the law of the

state where the obligor was located at the time a promissory note was executed. The creditor was located in Washington but had sought out the debtor's business in Colorado. The debtor subsequently moved to Washington and attempted to assert Washington defenses. The court rejected this attempt and held that notwithstanding the creditor's Washington location, the parties justifiably would have expected Colorado law to apply. The Washington Supreme Court commented, "Although petitioner's principal place of business is in Washington, petitioner was doing business in Colorado and had willingly subjected itself to Colorado law by entering into a contract with a Colorado resident and could justifiably assume that the Colorado law would likewise apply to petitioner's business debtor." 95 Wn.2d at 348.

Here the lenders were doing business in California centered on California transactions. They requested guarantees from the Californians. The lenders could justifiably assume that California law would apply to the guarantees. As in *Pacific Gamble Robinson*, the lenders' Washington location is not significant to the available defenses, while the guarantor's location at the time of contracting is significant.

In *Potlatch*, 76 Wn.2d at 812-13, the Washington Supreme Court again was faced with enforcement of a promissory note. Under Washington law, the community obligors would not be liable to the Idaho

creditor. The Supreme Court applied the law where the marital community was domiciled, i.e., Washington law. The Court did not apply the law where the creditor was located because the issue concerned “disabilities to sue and immunities from suit because of a family relationship.” The Court reasoned that the creditor was aware that it was dealing with Washington residents, knew that the encumbered property was located in Washington, and “would have been fairly certain that any execution of a judgment . . . would have to be in Washington courts.” *Id.* at 813. The Court recognized Washington’s vital interest by virtue of the community’s Washington domicile, that the property to be executed on was in Washington, and that Washington’s community property system was “the most important element of married women’s property rights.” *Id.* Washington had the more significant relationship to the portion of the transaction concerning the enforceability of the note against the community.

Similarly, this Court should conclude (1) Washington courts do not consider a creditor’s location to be as important as an obligor’s location for issues related to defenses and (2) California has the more significant relationship to the portion of the transaction concerning enforcement of the guaranty against the California guarantors.

Finally, in another guaranty case, *G.W. Equipment Leasing*, 97 Wn. App. 191 at 198, the appellate court concluded that Arizona’s interest

is paramount to the scope of the guarantors' liability where the "Arizona legislature has enacted a statute that prohibits one spouse from entering into guaranty contracts without the other spouse's consent." The Washington court applied Arizona law to whether the marital community was bound by the guaranty where the guarantors were located in Arizona and the creditor was located in Washington. The court applied Arizona law even though the underlying lease selected Washington law. *Id.* at 193. This is analogous to the present case. While the creditor was located in Washington, and received payments in Washington, for the particular issue of a guarantor's defenses, the domicile of the guarantor was paramount. As in *G.W. Equipment Leasing*, this Court should find the guarantors' California domiciles to be the most important contact where the California legislature has enacted a statute that prevents enforcement of the guarantees in these circumstances.

Policy considerations reinforce this conclusion. California has a strong policy interest in the subject matter, reflected in its longstanding statutes which have formed a cornerstone of California lender/debtor law since 1939. The California guarantors had the justifiable expectation of the application of California law. They were familiar with California law concerning guarantees, and specifically the requirement that a creditor first proceed against the collateral. These are the people the California

legislature intended to protect. This contact strongly favors the application of California law to the issue of whether California's code protections are available. Washington precedent demonstrates that these considerations are more important regarding enforcement of obligations than the choice of law selected in the notes.

In the first appeal this Court instructed that Washington precedent requires that the outcome of the significant relationship test control. Washington case law demonstrates that the guarantors' location is decisive. Where the record plainly discloses that the notes only selected Washington law to obtain favorable tax treatment for the lenders, that selection becomes even more attenuated from the guarantors' defenses.

The trial court failed to correctly perform the most significant relationship test and failed to heed the rationale and outcomes of *Granite Equip. Leasing*, *Pacific Gamble Robinson*, *G.W. Equipment Leasing*, and *Potlatch*. This Court should reverse.

**2. The Trial Court Misapplied the Proper Test When It Failed to Focus on the Most Important Contacts and Consider Relevant State Policies, Conducting Only a Partial Analysis**

The trial court wrongly concluded that Washington has the most significant relationship to the issue whether the guarantors can assert California statutory defenses to enforcement of the guarantees. The trial

court erred when it failed to identify the contacts that are most important to the particular issue of what defenses are available. The trial court blurred the transactions, with an inappropriate focus on the underlying loan transactions and no emphasis on the dealings regarding the guarantees. The trial court correctly identified the five contacts for consideration under § 188, see CP 974, lines 17-20, but failed to adequately weight these contacts. It also considered extraneous matters, which apparently swayed it. The trial court's consideration of each state's policies was deficient.

Initially, the trial court identified that (1) the place of contracting is California "because the guarantors signed the guarantees at the same time they signed the notes while they were in the state of California." CP 974, lines 1-4, (2) the place of performance is Washington, *id.* at line 5, (3) the place of negotiation is a "negligible" contact because the guarantees were not negotiated, CP 974, line 15 to CP 975, line 24,<sup>12</sup> (4) the location of the

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<sup>12</sup> Though finding the contact negligible, the trial court remarked that Freestone was made aware of MKA by an independent agent "who put them in contact with MKA, and in that sense, Freestone was contacted in the state of Washington." CP 975, lines 20-24. This comment, relating to how the loan transactions were initiated, illustrates the trial court's focus on the underlying transaction and not on the specific guarantee transactions. The trial court also answered the question of place of negotiation with respect to the loan transaction generally, not the guarantees. CP 974, line 15 to 975, line 19. This further illustrates the trial court's erroneous focus throughout the decision. Nonetheless, the

subject matter is Washington because the loans are paid in Washington, while recognizing that the real estate underlying the subject matter is in California, CP 975, lines 25-4, and (5) the parties are split in their domiciles. CP 975, lines 5-8. The guarantors do not take issue with these conclusions. But the trial court never identified which of these factors is most important to the issue what defenses the guarantors can assert. As noted in § 188, the contacts are not simply counted. The trial court failed to perform the required qualitative analysis. The most important contacts to the guarantors' ability to assert defenses are the place of contracting and the guarantors' domicile.

The trial court next considered the justified expectations of the parties, and concluded that Abraham's and Sugarman's expectation that the guarantees would be subject to California law (i.e., that the law as they knew the lenders first would have to pursue the principal and collateral before suing them) were unjustified. This Court should disagree. The trial court for some reason considered that employees of MKA drafted the guarantees, that Abraham and Sugarman "own the company," and that

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negotiation factor is probably negligible because the parties stayed in their respective locations when the guarantees were sought. It is undisputed that the lenders had MKA employees pass on to the guarantors *in California* that they requested personal guarantees. CP 383 33:2-9; CP 395 20:16 to 21:23. *The guarantees* were requested of the guarantors in California, and executed there.

Abraham and Sugarman are highly sophisticated. CP 975, line 17 to CP 976, line 25. The trial court stated that Abraham and Sugarman's testimony concerning their understanding of how the guarantees would work "contradicts what the guarantees themselves say." CP 976, lines 9-16.

This does not make sense. The guarantors testified that they were familiar with guarantees in California, and based on their prior experiences, they believed the lenders first would have to pursue the principal and collateral. This is a correct understanding of California law. The trial court makes the same error it made in its waiver analysis when it points to the language in the guarantees that the guarantors are "immediately" liable, and faults Sugarman's and Abraham's understandings. Again, the protections that apply to make the guarantees not immediately payable are *based on statute*. They are not protections apparent on the face of the guarantee documents. The trial court fails to acknowledge that no matter what the guarantees state, it is *the statute* that protects the guarantors from being immediately liable (assuming the statutory protections had not been expressly waived, which they had not).

The trial court's criticism of Abraham's and Sugarman's understanding is unwarranted. It appears the trial court penalized Abraham and Sugarman based on its impression that they should have known better. The trial court failed to make all inferences in their favor for purposes of

the lenders' summary judgment motion. Moreover, their understanding, was *correct* regarding the California guarantees with which they were familiar. They were justified in their expectation, and they had no counsel to assist them. CP 975, line 20.

The trial court failed to identify and weigh the relevant policies. The trial court never identified any Washington policy or interests relevant to the analysis, and demonstrated a lack of interest in weighing the interests of both states. The trial court made a single remark about policy. The trial court mentioned regarding policy that California's Cal. Civ. Code § 1646 states that a contract should be interpreted according to the law where it is to be performed. CP 976, line 20, to 977, line 13. The court stated, "So this is not determinative of the case, but certainly evidence of the policies of the State of California." What policies those are, the trial court did not say. Nor did the trial court attempt to weigh whatever those policies are with his stated view that "it is certainly important under the State of California that guarantors are protected." CP 977, lines 1-2.

California's interest in protecting guarantors located in California is primary. It reflects a legislative choice existing since 1939 based in equitable principles. California's statute stating a rule for choice of law in

*contract construction*, § 1646, has no impact on these policies.<sup>13</sup> The trial court should have determined that California had the greater interest in the issue and accommodated California's policies by permitting the guarantors to raise the statutory defenses.

The trial court failed to identify any countervailing policies of Washington. This was contrary to § 6 which emphasizes that such accommodation of each state's policies is the goal of the conflict of laws analysis. Washington has no specific policies at stake, other than a general interest in enforcing contracts. Washington has no policy that conflicts with the longstanding California policies.

Instead of completing the required analysis, the trial court jumped to the conclusion that "the choice of law should be Washington." CP 978, line 8. The trial court's analysis was faulty and incomplete. California law should apply to the issue whether the guarantors can require that the lender first pursue the principal and collateral. Reversal is warranted.

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<sup>13</sup> The trial court incorrectly remarked that § 1646 states both a choice of law rule and a conflicts of law rule. CP 977, lines 9-11. This is wrong. It is a choice of law rule for contract construction, not a tool for conflicts of laws. See *Frontier Oil. Corp. v. RLI Insurance Co.*, 153 Cal. App. 4<sup>th</sup> 1436, 1449 (2007) (§ 1646 is a choice of law rule that determines the law governing interpretation of a contract); *Colorado Casualty Ins. Co., v. Candelaria Corp.*, 2010 U.S. Dist. LEXIS 31363 (C.D. CA. 2010)(§ 1646 concerns contract interpretation, not whether a California state applies). It is undisputed, moreover, that *Washington's* conflict of laws rules apply

**D. The Trial Court Overlooked the Guarantors' Exoneration Evidence, Which Establishes Material Questions of Fact Under Both Washington and California Law**

The guarantors argued that they were exonerated under either Washington or California law, because they did not consent to the Subordination Agreement which materially altered their obligations and the lenders' remedies against MKA. CP 299-301. Mere knowledge of an agreement is not sufficient to establish consent to the agreement by a guarantor. *R.P. Richards, Inc. v. Chartered Construction Corp.*, 83 Cal. App. 4<sup>th</sup> 146, 155 n.9 (2000).<sup>14</sup> The lenders have no evidence of consent and the evidence of knowledge is disputed. The trial court failed to analyze this defense, which should have prevented summary judgment.

**1. Under Both States' Laws, the Lenders Cannot Enforce Greater Obligations Against the Guarantors Than They Can Against the Principal Absent Consent, Which Is Lacking**

Under both Washington and California law, guarantors are exonerated by alteration of their obligation, including impairment of the creditors' remedies against the principal without their consent. In California, this rule is codified and established by case law. *See* Cal. Civ.

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here, *see Freestone v. MKA, supra*, which the trial court correctly acknowledged.

<sup>14</sup> In *R.P. Richards, Inc.*, the surety was notified of an impending settlement between the principal and the obligee, but did not join it. The

Code § 2819; *Bennett v. Leatherby*, 3 Cal. App. 4<sup>th</sup> 449, 452 (1992); *Massachusetts Bonding & Ins. Co. v. Osborne*, 233 Cal. App. 2d 648, 661 (1965) (“[P]laintiff by its action in covenanting not to execute against John for his liability as a partner has denied her this right [of subrogation]. Thereby, her obligation of indemnity terminated.”). *Lack* of knowledge establishes lack of consent. *See Hill & Morton v. Coughlan*, 214 Cal. App. 2d 545, 549-50, 29 Cal.Rptr. 550 (1963). As noted, knowledge alone does not establish consent. *R.P. Richards, Inc.*, 83 Cal. App. 4<sup>th</sup> at 155 n.9.

Washington does not permit a creditor to impair a guarantor's subrogation rights, a point which the guarantors brought to the trial court's attention in their opposition to summary judgment. *See* CP 301 note 34.

The rule in Washington, which parallels the California rule, is:

When the creditor intends to look to the surety for payment he is compelled to preserve, unimpaired, all his rights against the debtor. If the creditor therefore does any act without the surety's consent, which impairs his rights of subrogation or the means of enforcing his claim against the principal in case he should be called upon to pay the debt, the surety will be discharged.

*National Bank of Washington v. Equity Investors*, 86 Wn.2d 545, 556, 546 P.2d 440 (1976). Under both Washington and California law, the lenders' execution of the Subordination Agreement, which favored MKA over the

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Court held that notice of the agreement was an insufficient basis to find consent. The surety was exonerated.

guarantors and impaired the lenders' rights against MKA, should be found to discharge the guarantors.

Mr. Abraham executed three notes prior to execution of the Subordination Agreement; he executed the rest after execution of the Subordination Agreement but with no knowledge of it. See CP 105-139. The Subordination Agreement required the lenders to mark future notes subject to the Subordination Agreement, but the lenders never did. Mr. Abraham was not a party to the Subordination Agreement. CP 366, 371-73. He learned of the Subordination Agreement afterwards and before he executed the 2008 note extension agreements. CP 934 63:13-25. He did not understand the ramifications of the Subordination Agreement to him. CP 934, 63:1-5. The note extension agreements are silent as to the Subordination Agreement. Pursuant to their integration clause, CP 950 at ¶ 15,<sup>15</sup> the silent note extension agreements *cannot* establish consent. No evidence of consent exists. At the very least, a question of fact exists whether by executing the note extension agreements after he had read the

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<sup>15</sup> This integration clause, which undermines the lenders' argument, reads:

Except as otherwise stated, **this Agreement supersedes any prior arrangements and includes all understanding of the parties** with regard to the extension of new credit and forbearance from collection of any obligations or the enforcement of the [Notes] or the [Security Agreements].

Subordination Agreement, Mr. Abraham consented to liability in excess of the principal's liability and to alteration of the principal's obligation.

The lenders offered no evidence that Mr. Sugarman consented. Like Mr. Abraham, Mr. Sugarman was not a party to the Subordination Agreement. CP 366, 371-373. He testified he had no knowledge of the Subordination Agreement at all times relevant. CP 399-400 at 49:5-50:6. The lenders offered evidence that they argue contradicted his testimony regarding knowledge. This evidence is printed emails showing that various parties copied Mr. Sugarman on emails concerning the Subordination Agreement. CP 902, ¶¶ 3-4; CP 904-13. The record demonstrates the issue of Mr. Sugarman's knowledge is disputed. Knowledge, is not tantamount to consent. The lenders showing did not support summary judgment against Sugarman.

The lenders argued that that Mr. Sugarman cannot be discharged because the Subordination Agreement was executed *before* he signed the guarantees. CP 858-59. They make this same argument premised on timing as to the three guarantees that Mr. Abraham signed after the Subordination Agreement was executed. *Id.* This argument misses the point: the lenders cannot enforce against the guarantors obligations that exceed the principal's obligations, absent consent. This rule of guaranty

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CP 950 at ¶ 15 (emphasis added).

law applies whether the obligations were altered subsequent to the guarantees, or if the obligations were greater at the time the guarantees were signed without full disclosure to the guarantors that they were assuming obligations in excess of the principal's obligations.

A guarantor cannot have a greater obligation than the principal. Cal. Civ. Code § 2809; *Mortgage Finance Corp. v. Howard*, 210 Cal. App. 2d 569, 572 (1962) (lender cannot place principal in a more favored position than guarantors); *Robey v. Walton Lumber Co.*, 17 Wn.2d 242, 255, 135 P.2d 95 (1943) (obligor's primary obligation of performance must exist for contract of guaranty to exist and general rule is that liability of the principal debtor measures and limits the liability of the surety); *Lilenquist Motors, Inc. v. Monk*, 64 Wn.2d 187, 189, 390 P.2d 1007 (1964) (guarantor's obligation cannot, without consent, be altered from explicit terms of guaranty). The Subordination Agreement requires MKA to pay Gottex before the lenders the guarantors cannot be required to pay the lenders earlier. This Court should reject any argument that some of the guarantees are enforceable because the guarantors were ignorant of the *preexisting* Subordination Agreement. Consent is required. If the lenders are arguing simply that the guarantors "must have known" of the pre-existing Subordination Agreement and therefore consented, their evidence

is deficient. The integrated note extension agreements say nothing about the Subordination Agreement.

The Subordination Agreement placed MKA in a more favorable position than the guarantors without the guarantors' consent. Exoneration or discharge results. The guarantors' exoneration defense justified denial of summary judgment under both California and Washington laws.

**2. The Trial Court Failed to Perform a Conflicts Analysis and Consider the Defense of Exoneration.**

This Court should reverse so that the merits of the exoneration defense can be reached. The trial court failed to perform a conflict analysis to determine if California's law regarding exoneration conflicted with Washington law. There is no conflict, as the guarantors asserted in opposition to summary judgment. CP 301 note 34. The lenders never argued that a conflict exists. The trial court should have denied summary judgment, permitted the guarantors to amend their complaint to clarify the exoneration defense, and moved forward with resolution of disputed issues of material fact regarding whether the guarantors ever consented to the Subordination Agreement.

The guarantors opposed summary judgment on the grounds, among others, that the lenders could not enforce greater obligations against them than against the principal, and that the Subrogation

Agreement forestalling collection against the principal discharged their obligations. CP 299-301. The guarantors argued that both California and Washington laws compelled this result. CP 301 note 34. The guarantors simultaneously moved to amend their Answer to clarify that affirmative defenses previously stated in more general language included the defense that the lenders' failure to obtain consent to the Subordination Agreement impaired their rights and exonerated them. CP 260-79.<sup>16</sup>

In the lenders' reply supporting their motion for summary judgment, the lenders failed to rebut the guarantors' briefing that Washington law produced the same result as California law on this point. *See* CP 858-59. The lenders, therefore, have never argued that Washington law would not support exoneration on these facts. This alone justifies reversal and remand. There is no conflict of laws on this issue. The summary judgment motion should have been denied based on the exoneration defense and issues of fact related to it.

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<sup>16</sup> Specifically, the guarantors sought to add a paragraph enunciating the specific defense that:

Plaintiffs failed to obtain consent of the Guarantors prior to entering into the Subordination Agreement, which impaired the rights and remedies of Plaintiffs against the debtor. Under Cal. Civ. Code § 2819, the Guarantors' obligations under the guaranty contracts are exonerated.

CP 278 at lines 4-7.

The lenders objected to amendment of the answer, asserting prejudice and futility. CP 914-922. They established neither. The original pleading puts the lenders on notice of this defense, the lenders had actual notice of the defense based on litigation in California, the lenders demonstrated neither surprise nor hardship, and questions of fact prevented the conclusion that amendment was futile. *See* CP 955-959. The lenders' complaints about delay are unpersuasive; delay alone is insufficient to deny a motion to amend. *Caruso v. Local Union No. 690 of Int'l Bd. Of Teamsters*, 100 Wn.2d 343, 350-51, 670 P.2d 240 (1983). This case barely had proceeded before the parties engaged in motion practice and the lenders' obtained the first summary judgment that brought this case before this Court in 2010. Amendment is freely granted and should have been granted on remand from the first appeal. When the trial court determined that the guarantors had waived their defenses under California law and that Washington law applied, it failed to consider the exoneration defense. It denied the motion to amend as "moot," with no consideration of its merit. CP 962, lines 1-3. This was an abuse of discretion.

This Court should reverse the denial of the motion to amend and remand for further proceedings regarding the exoneration defense. Material disputes of fact exist as to whether the guarantors consented to

the terms of the Subordination Agreement, agreeing to be immediately liable despite the lenders' forbearance to MKA and the collateral.

**E. This Court Should Not Consider Futility of Pursuit of the Principal and Collateral as an Alternative Ground for Affirmance, the Lenders Having Failed to Cross Appeal the Trial Court's Proper Ruling That Questions of Fact Prevent Summary Judgment on That Issue**

The guarantors anticipate that the lenders may attempt to argue an alternative ground for affirmance based on futility of pursuit of the principal and collateral. The Court should reject such an effort.

The lenders argued on summary judgment that even if California law applied, they should not be required to pursue the principal or collateral because to do so would be futile because MKA possessed insufficient assets. CP 229-230. The trial court correctly found that questions of fact about the liquidity and assets of MKA existed, preventing summary judgment on this basis. CP 981, line 20 to 982, line 2. The lenders did not appeal. Therefore, they are not entitled to reversal of this ruling. RAP 2.4(a) (appellate court will grant respondent affirmative relief only if respondent also seeks review). The trial court, moreover, was correct that issues of fact prevent summary judgment. The guarantors presented ample competing evidence. CP 513-518, 508 ¶ 4. Finally, the guarantors also argued that even if futility were factually established, which it was not, the lenders' own delay caused any futility, resulting in

exoneration. CP 301-302, § G, citing Cal. Civ. Code § 2823; see also CP 354 ¶¶ 6-7.

The “futility” argument presents no alternative grounds for affirmance for these reasons.

## **VI. CONCLUSION**

The trial incorrectly performed the conflict of laws analysis. On *de novo* review, this Court should conclude California law applies to the issue of the guarantors’ available defenses and reverse the summary judgment.

First, the trial court’s analysis of the waiver issue was flawed. The guarantees do not contain a waiver of California’s statutory defenses. Critically, under either state’s laws, the lack of an expression of an intent to waive the statutory protections foreclosed the trial court’s construction. Because there was no waiver, a conflict between Washington and California law exists.

Second, California had the most significant relationship with the guarantees and the issue of the defenses available to the guarantors. All significant contacts important to the creation of the guarantees—not to the underlying loan transaction—occurred in California. The lenders requested the guarantees of the California lenders located in California, who executed the guarantees in California, and who were familiar with California guarantees. These contacts are more important to the issue of

the guarantors' available defenses than the fact that payment was to be sent to Washington. The guarantors justifiably expected that the lenders could not pursue them before pursuing the principal and collateral. The strong policies of California to protect guarantors should have been accommodated. Washington has no countervailing policies that overcome California's well-established interest in protecting guarantors on grounds of equity by permitting them to demand that the principal and collateral first be pursued. This Court should reverse the money judgments and remand for further proceedings pursuant to the California defenses.

Finally, the Court should reverse and remand for trial the exoneration issue. Fundamentally, guarantors do not assume greater obligations than their principal. Here, the lenders seek to enforce greater obligations against the guarantors where the guarantors never consented to such liability. This contravenes both Washington and California laws and supports reversal. At the least, questions of fact exist as to the guarantors' knowledge and consent that justify a jury trial.

Respectfully submitted this 4<sup>th</sup> day of March, 2011.

  
\_\_\_\_\_  
Christopher H. Howard, WSBA #11074  
Averil B. Rothrock, WSBA #24248  
Virginia Nicholson, WSBA #39601  
*Attorneys for Appellants,*  
Michael Abraham and Jason Sugarman

**CERTIFICATE OF SERVICE**

I certify and declare that on the 4<sup>th</sup> day of March, 2011, I caused to be served by first class U.S. Mail the foregoing Opening Brief on the following parties at the following addresses:

Ragan Powers  
Brad Fisher  
Davis Wright Tremaine LLP  
1201 Third Ave Ste 2200  
Seattle, WA 98101-3045

  
Averil Rothrock, WSBA #24248

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default or failure of condition shall be effective, unless the waiver is expressly stated in a writing signed by Lender. All of Lender's remedies in connection with this Note or under applicable law shall be cumulative, and Lender's exercise of any one or more of those remedies shall not constitute an election of remedies. Maker hereby waives demand, presentment, protest, notice of dishonor, suit against any party and all other requirements necessary to charge or hold Maker on any obligation.

13. This Note inures to and binds the heirs, legal representatives, successors and assigns of Maker, Lender, and Lenders' agents; provided, however, that Lender in its sole discretion may assign or transfer all or any portion of this Note, all without notice to, or the consent of, Maker.

14. Time is of the essence with respect to every provision contained herein in which time is a factor.

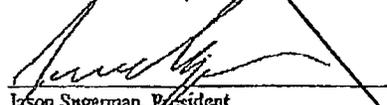
15. It is the intention of Maker and Lender to conform strictly to the usury laws now or hereafter in force in the State of Washington, and any interest payable under this Note shall be subject to reduction to the amount not in excess of the maximum non-usurious amount allowed under the usury laws of the State of Washington as now or hereafter construed by the courts having jurisdiction over such matters. In the event any payment made hereunder is in violation of the usury laws now or hereafter in force in the State of Washington, then earned interest will not include more than the maximum amount permitted by law, and any interest in excess of the maximum amount permitted by law shall be deemed canceled automatically upon the payment thereof by Maker and shall, at the option of Lender, either be rebated to Maker or credited on the principal amount of this Note or, if all principal has been paid, then the excess shall be rebated to Maker.

IN WITNESS WHEREOF, the undersigned has duly executed and delivered this Unsecured Promissory Note as of the date first above written.

MAKER

MKA REAL ESTATE OPPORTUNITY FUND I, LLC,  
a California limited liability company

By:

  
Jason Sugarman, President

THE UNDERSIGNED HEREBY UNCONDITIONALLY GUARANTIES 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.

  
Michael A. Abraham





26 Corporate Plaza Drive  
Suite 250  
Newport Beach, CA 92660  
(949) 729.1660  
FAX (949) 729.1665  
Website: www.mkaoop.com

**SECURED PROMISSORY NOTE**

\$8,100,000

May 8, 2006

FOR VALUE RECEIVED, MKA REAL ESTATE OPPORTUNITY FUND I, LLC, a California limited liability company ("Maker") promises to pay to FREESTONE CAPITAL PARTNERS L.P. ("Lender"), at such address as Lender from time to time may designate in writing, the principal sum of eight million one hundred thousand dollars (\$8,100,000), advanced to Maker hereunder plus interest (the "Loan") in accordance with the terms of this secured promissory note (the "Note").

1. The Maker agrees to pledge, assign, mortgage or otherwise grant a security interest in any or all assets of the Maker, to execute and deliver to the Lender such security agreements, assignments, mortgages, financing statements, hypothecations, agreements not to encumber and other agreements as may be requested by the Lender from time to time.

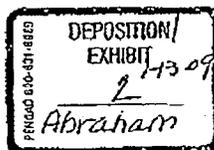
2. Interest shall accrue in arrears on the principal of this Note outstanding at any time at the rate of one percent (1.00%) per month (the "Interest Rate") from the date of this Note to and including the Maturity Date (as defined herein) computed daily on the basis of a three hundred sixty (360)-day year and actual days elapsed. Interest shall be payable in full on the Maturity Date.

3. The Loan shall be paid to Maker in three installments as follows: \$3,000,000 on November 30, 2006, \$2,000,000 on January 31, 2007 and the remaining principal balance of \$3,100,000 and all accrued unpaid interest on March 30, 2007 (the "Maturity Date"). This Note may be prepaid, in whole or in part, at any time, provided that if Maker elects to prepay this Note, Maker will also pay to Lender a prepayment fee in the amount of one percent (1%) of the principal amount being prepaid at the time of such prepayment.

4. The Maker attests that the only credit arrangements they have in place as of the date of this note are with PFF/Alliance for forty-five million dollars (\$45,000,000) and Gottex Fund Management Ltd. for twenty million dollars (\$20,000,000), not including promissory notes with the Lender or affiliates of the Lender. Maker attests that they do not have any other agreements with creditors other than those listed in item 4 and have not assigned, pledged, mortgaged or otherwise granted a security interest in any of its assets to another creditor.

5. Maker agrees to provide the Lender with unaudited financial statements within 30 days of the end of each month that there is a balance payable on the Loan.

6. If Maker fails to make any payment hereunder within ten (10) days after it becomes due and payable, or renew the Note with the Lender, Maker agrees that the note shall continue to accrue interest at the Interest Rate and to pay to Lender a late charge (the "Late Charge") equal to three percent (3%) of such delinquent payment including accrued interest. Maker acknowledges that in the event Maker fails to make any payment when due hereunder, the damages to Lender would be difficult to ascertain and would include the loss of use of funds and expenses incurred in connection with such default, and that the Late Charge is a fair and reasonable estimate of the loss to Lender as a result of such default.



7. If any of the following "Events of Default" occur the balance of all principal and interest under this Note shall, at the Lender's option, exercisable in Lender's sole discretion, become immediately due and payable without notice of default, presentment or demand for payment, protest or notice of nonpayment or dishonor, or other notices or demands of any kind or character:

- (a) Maker fails to perform any other obligation under this Note to pay money and does not cure that failure within five (5) days after written notice from Lender;
- (b) Maker receives notice to redeem and/or pays redemptions to its shareholders, partners, members or owners, and such value exceeds 20% of the Maker's net asset value prior to the payment of such redemptions;
- (c) Maker pays redemptions to its shareholders, partners, members or owners, and the cumulative value of such redemptions from the date of the Note exceeds 30% of the Maker's net asset value as of the date of the Note;
- (d) Maker becomes the subject of any bankruptcy or other voluntary or involuntary proceeding, in or out of court, for the adjustment of debtor-creditor relationships ("Insolvency Proceeding"), or
- (e) Maker's debt to equity ratio exceeds 25%.

The Maker agrees to notify the Lender of any such "Events of Default" immediately. Additionally, if an "Event of Default" occurs, Maker agrees to pay Lender any amounts owed under this Note prior to making distributions to shareholders, partners, members or owners.

8. All amounts payable under this Note are payable in lawful money of the United States. Checks constitute payment only when collected. Except as otherwise expressly provided herein, all payments made hereunder shall be applied first to Late Charges, then to additional sums due hereunder, then to accrued, unpaid interest until all Late Charges, additional sums and accrued, unpaid interest are paid and finally to principal.

9. If any proceeding is commenced which arises out of or relates to this Note, the prevailing party shall be entitled to recover from the other party such sums as may be adjudged to be reasonable attorneys' fees, in addition to costs and expenses otherwise allowed by law. In all other situations, including any matter arising out of or relating to any Insolvency Proceeding, Maker agrees to pay all of Lender's, and Lender's agents costs and expenses, including attorneys' fees, which may be incurred in enforcing or protecting Lender's or Lender's agents rights or interests.

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

11. Maker agrees that the Lender may accept security for this Note, or release any security or any party liable for this Note, or extend or renew this Note, all without notice to Maker and without affecting the liability of Maker.

12. If Lender delays in exercising or fails to exercise any of its rights under this Note, that delay or failure shall not constitute a waiver of any of Lender's rights, or of any breach, default or failure of condition of or under this Note. No waiver by Lender of any of its rights, or of any such breach,

default or failure of condition shall be effective, unless the waiver is expressly stated in a writing signed by Lender. All of Lender's remedies in connection with this Note or under applicable law shall be cumulative, and Lender's exercise of any one or more of those remedies shall not constitute an election of remedies. Maker hereby waives demand, presentment, protest, notice of dishonor, suit against any party and all other requirements necessary to charge or hold Maker on any obligation.

13. This Note inures to and binds the heirs, legal representatives, successors and assigns of Maker, Lender, and Lenders' agents; provided, however, that Lender in its sole discretion may assign or transfer all or any portion of this Note, all without notice to, or the consent of, Maker.

14. Time is of the essence with respect to every provision contained herein in which time is a factor.

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 hereafter construed by the courts having jurisdiction over such matters. In the event any payment made hereunder is in violation of the usury laws now or hereafter in force in the State of Washington, then earned interest will not include more than the maximum amount permitted by law, and any interest in excess of the maximum amount permitted by law shall be deemed canceled automatically upon the payment thereof by Maker and shall, at the option of Lender, either be rebated to Maker or credited on the principal amount of this Note or, if all principal has been paid, then the excess shall be rebated to Maker.

IN WITNESS WHEREOF, the undersigned has duly executed and delivered this Unsecured Promissory Note as of the date first above written.

MAKER

MKA REAL ESTATE OPPORTUNITY FUND I, LLC,  
a California limited liability company

By: \_\_\_\_\_

*[Signature]*  
Eason Sugarman, President

THE UNDERSIGNED HEREBY UNCONDITIONALLY GUARANTIES 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.

*[Signature]*  
Michael A. Abraham



## SECURITY AGREEMENT

THIS SECURITY AGREEMENT (this "Agreement") is made and entered into as of April 2, 2007, by and between MKA REAL ESTATE OPPORTUNITY FUND I, LLC, a California limited liability company having its principal place of business at 26 Corporate Plaza Drive Suite 250 Newport Beach, CA 92660 (the "Debtor"), and Freestone Low Volatility Qualified Partners LP having its principal place of business at 1191 Second Avenue, Suite 2100, Seattle, Washington 98101 (the "Lender").

The Debtor and the Lender hereby agree as follows:

### I. DEFINITIONS.

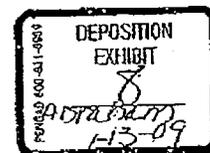
Each reference herein to:

- (a) "Accounts," "chattel paper," "documents," "equipment," "financial assets," "fixtures," "general intangibles," "goods," "instruments," "investment property," "equipment," "cash," "deposit accounts," "proceeds," "securities," and "securities accounts," shall have the meaning assigned to each in the Uniform Commercial Code (the "UCC") from time to time in effect in the State (as defined below).
- (b) "Books and records" shall mean all books, correspondence, credit files, records and other documents relating directly or indirectly to the Obligations and the Collateral, including, without limitation, all tapes, cards, runs, data bases, software programs, diskettes, and other papers and documents in the possession or control of the Debtor, any computer service bureau, or other agent or independent contractor.
- (c) "Note" shall mean the Secured Promissory Note issued by the Debtor in favor of the Lender and dated April 2, 2007.
- (d) "Obligations" shall mean all indebtedness and liabilities evidenced by the Note.
- (e) "Person" shall mean an individual, a corporation, a government or governmental subdivision or agency, business trust, estate, trust, partnership or association, limited liability company, two or more persons having a joint or common interest, or any other legal or commercial entity.
- (f) "State" shall mean the State of Washington.

### II. GRANT OF SECURITY INTEREST.

Security Interest; Collateral; Obligations. The Debtor hereby grants to the Lender a security interest in and agrees and acknowledges that the Lender has and will continue

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to have a security interest in and lien on all property and assets of the Debtor of every kind and nature, wherever located, now owned or hereafter acquired or arising, and all products and proceeds thereof, including, without limitation, all goods, accounts including without limitation all accounts receivable, all deposit accounts and all securities accounts, contract rights, rights to the payment of money including tax refund claims, insurance proceeds and tort claims, cash, chattel paper, documents, financial assets, instruments, general intangibles, securities, patents, trademarks, trade names, copyrights, service marks, applications for patents, trademarks, copyrights and service marks, books and records, furniture, fixtures, equipment, inventory, investment property and all other capital assets (all such properties, assets and rights hereinafter called, collectively, the "Collateral")

### III. REPRESENTATIONS, WARRANTIES AND COVENANTS.

Debtor hereby represents, warrants, covenants and agrees that:

1. **Organization and Powers.** The Debtor is duly organized, validly existing and in good standing under the laws of the state of California. The Debtor has the power and authority to own its properties and to carry on its business as now being conducted and is qualified to do business in every jurisdiction where such qualification is necessary. The Debtor has the power to execute and perform this Agreement and to grant the security interests in the Collateral to the Lender. The execution and performance by the Debtor of the terms and provisions of this Agreement have been duly authorized by all requisite action.
2. **Location of Principal Executive Office.** The Debtor represents to the Lender that the location of the Debtor's principal executive office and the location where the books and records of the Debtor are kept is 26 Corporate Plaza Drive Suite 250 Newport Beach, CA 92660. The Debtor agrees that it will not change its name, the location of its principal executive office or the location where its books and records are kept without prior written notice to Lender and will advise the Lender as to any change in the location (except for temporary changes in the normal and customary use thereof) for any property comprising a part of the Collateral at least thirty (30) days prior to such change.
3. **Preservation of Collateral.** If an Event of Default under the Note has occurred and is continuing, the Lender may, at its election, discharge taxes and liens levied or placed on the Collateral, pay for insurance on the Collateral and pay for the maintenance and preservation of the Collateral. The Debtor agrees to reimburse the Lender on demand for any payment made, or any expense incurred by the Lender pursuant to the foregoing authorization, and in any event all such payments and expenses shall constitute an Obligation hereunder.
4. **Possession and Use.** Until an Event of Default, the Debtor may have possession of the Collateral, provided that the Debtor will not use the Collateral in any unlawful manner or in a manner inconsistent with this Agreement.
5. **Power of Attorney.** In the Event of Default, the Debtor irrevocably designates and appoints the Lender, its true and lawful attorneys with full power of substitution and revocation to execute, deliver, and record in the name of the Debtor all financing statements, amendments, continuation statements, title certificate lien applications and other documents

deemed by the Lender to be necessary or advisable to perfect or to continue the perfection of the security interests granted hereunder.

6. **Assignments or Liens.** The Debtor will not create or permit to be created any lien, encumbrance or security interest of any kind on any of the Collateral other than for the benefit of the Lender, nor grant or permit to be granted any guaranty other than for the benefit of the Lender, except in connection with (i) loans obtained by Debtor which do not result in Debtor's outstanding debt being in an amount greater than twenty five percent (25%) of Debtor's total debt and equity capital, as shown on Debtor's most recent financial statements, or (ii) debt expressly subordinate to the Note. Nothing contained herein shall be deemed to restrict Debtor's right to grant participations in its assets to co-managed entities.

7. **Remedies.**

Upon an Event of Default (as defined in the Note), the Lender may, subject to the other terms of this Agreement, without notice or demand declare this Agreement to be in default, and thereafter, to the fullest extent permitted by applicable law:

- (a) The Lender shall have, in addition to all other rights and remedies given it by any instrument or other agreement evidencing, or executed and delivered in connection with, any of the Obligations and otherwise allowed by law, the rights and remedies of a secured party under the Uniform Commercial Code as enacted in any jurisdiction in which the Collateral may be located, and without limiting the generality of the foregoing, the Lender may, without (to the fullest extent permitted by law) demand of performance or advertisement or notice of intention to sell or of time or place of sale or of redemption or other notice or demand whatsoever (except that the Lender shall give the Debtor at least ten days' notice of the time and place of any proposed sale or other disposition), all of which are hereby expressly waived to the fullest extent permitted by law, sell at public or private sale or otherwise realize upon, at such place as shall be determined by the Lender, the whole or from time to time any part of the Collateral in or upon which the Lender shall have a security interest or lien hereunder, or any interest which the Debtor may have therein, and after deducting from the proceeds of sale or other disposition of the Collateral all expenses (including all reasonable expenses for legal services) shall apply the residue of such proceeds toward the payment of the Obligations, the Debtor remaining liable for any deficiency remaining unpaid after such application. If notice of any sale or other disposition is required by law to be given to the Debtor, the Debtor hereby agrees that a notice given as provided herein shall be reasonable notice of such sale or other disposition. The Debtor also agrees to assemble the Collateral at such place or places as the Lender reasonably designates by written notice. At such sale or other disposition the Lender may, and any other

person or entity owed any Obligation may itself, purchase the whole or any part of the Collateral sold, free from any right of redemption on the part of the Debtor, which right is hereby waived and released to the fullest extent permitted by law.

- (b) Furthermore, without limiting the generality of any of the rights and remedies conferred upon the Lender under this Section 8, the Lender to the fullest extent permitted by law, may enter upon the premises of the Debtor, exclude the Debtor therefrom and take immediate possession of the Collateral, either personally or by means of a receiver appointed by a court therefor, using all necessary force to do so, and may, at their option, use, operate, manage and control the Collateral in any lawful manner and may collect and receive all income, revenue, earnings, issues and profits therefrom, and may maintain, repair, renovate, alter or remove the Collateral as the Lender may determine in its discretion, and any such moneys so collected or received by the Lender shall be applied to, or may be accumulated for application upon, the Obligations in accordance with this Agreement.
- (c) The Lender agrees that it will give notice to the Debtor of any enforcement action taken by them pursuant to this Section 8 promptly after commencing such action.

#### IV. MISCELLANEOUS.

1. **Fees and Expenses.** Any and all reasonable fees, costs and expenses, of whatever kind or nature, including reasonable attorneys' fees and legal expenses and other reasonable professional fees and expenses incurred by the Lender, in connection with the payment or discharge of any taxes, liens, security interests or encumbrances, insurance premiums, or otherwise protecting, maintaining or preserving the Collateral, the release or partial release of Collateral from the security interest of this Agreement, in attempting to collect the Obligations, or the enforcing, foreclosing, retaking, holding, storing, processing, selling or otherwise realizing upon the Collateral and the Lender's security interest therein, whether through judicial proceedings or otherwise, or in defending or prosecuting any actions or proceedings arising out of or related to the transaction to which this Agreement relates, shall be deemed Obligations hereunder and shall be borne and paid by the Debtor on demand to the Lender.

2. **Waiver.** No failure to exercise, or delay in exercising, on the part of the Lender, any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or privilege hereunder or thereunder preclude any other or further exercise thereof or the exercise of any other right, power or privilege.

3. **Choice of Law; Unenforceability.** This Agreement shall be construed in accordance with and governed by the local laws (excluding the conflict of laws rules, so-called) of the State. The provisions of this Agreement are severable, and if any clause or provision shall

be held invalid or unenforceable in whole or in part in any jurisdiction, then such invalidity or unenforceability shall affect only such clause or provision, or part thereof, in such jurisdiction and shall not in any manner affect such clause or provision in any other jurisdiction, or any other clause or provision of this Agreement in any jurisdiction.

4. **Modification.** This Agreement is subject to modification only by a writing signed by the Lender and the Debtor.

5. **Successors and Assigns.** The benefits and burdens of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the Debtor and Lender; provided, however, that the rights and obligations of the Debtor under this Agreement shall not be assigned or delegated without the prior written consent of the Lender, and any purported assignment or delegation without such consent shall be void.

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, or any Federal Court of the United States of America located in the State, as the Lender may elect, and by execution and delivery of this Agreement the Debtor hereby submits to and accepts with regard to any such action or proceeding, for itself and in respect of its property, generally and unconditionally, the jurisdiction of the aforesaid courts. The Debtor further irrevocably consents to the service of process in any such action or proceeding by the mailing of copies thereof by registered or certified mail, postage prepaid, to the Debtor at its address set forth herein. The foregoing, however, shall not limit the Lender's rights to serve process in any other manner permitted by law or to bring any legal action or proceeding or to obtain execution of judgment in any other jurisdiction.

7. **Notices.** Except as otherwise specifically provided for herein, any notice, demand or communication hereunder shall be given in writing (including facsimile transmission or telex) and mailed or delivered to each party at its address set forth below, or, as to each party, at such other address as shall be designated by such party by a prior notice to the other party in accordance with the terms of this provision. Any notice to a Lender shall be sent as follows:

Freestone Low Volatility Qualified Partners L.P.  
1191 Second Avenue, Suite 2100  
Seattle, Washington 98101  
Attention: Arthur Goldman  
Telephone: (206) 398-1100  
Telecopy: (206) 398-0310

with a copy to

Finn Dixon & Herling LLP  
177 Broad Street, 15th Floor  
Stamford, CT 06901  
Attention: Matthew S. Eisenberg  
Telephone (203) 325-5084  
Telecopy 203) 325-5001

Any notice to the Debtor shall be sent as follows:

MKA Capital Group Inc.  
26 Corporate Plaza Drive Suite 250  
Newport Beach, CA 92660  
Attention: Jason Sugaman  
Telephone: (949) 729-1660  
Telecopy: (949) 729-1665

All notices hereunder shall be effective (i) five (5) business days after such notice is mailed, by registered or certified mail, postage prepaid (return receipt requested), (ii) upon delivery by hand, and (iii) in the case of any notice or communication by telex, telex or telecopy, on the date when sent.

8. Counterparts. This Agreement may be executed by the parties hereto individually or in any combination, in one or more counterparts, each of which shall be an original and all of which shall together constitute one and the same agreement.

9. Descriptive Headings; Context. The captions in this Agreement are for convenience of reference only and shall not define or limit any provision. Whenever the context requires, reference in this Agreement to the neuter gender shall include the masculine and/or feminine gender, and the singular number shall include the plural, and, in each case, vice versa.

IN WITNESS WHEREOF, the Debtor and the Lender have executed the foregoing Security Agreement as of the 2<sup>nd</sup> day of April, 2007.

DEBTOR

MKA REAL ESTATE OPPORTUNITY FUND I, LLC  
By: MKA Capital Group Inc., manager

By: Michael M. Abraham  
Name: Michael Abraham  
Title: CEO

LENDER

FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS LP.  
By: Freestone Investments LLC, its General Partner

By: \_\_\_\_\_  
Name: Gary I. Furukawa  
Title: Manager



## NOTE EXTENSION AGREEMENT (FLVQP)

THIS AGREEMENT ("Agreement") is entered into as of February 21, 2008, by and among FREESTONE LOW VOLATILITY QUALIFIED PARTNERS L.P. ("FLVQP"), MKA REAL ESTATE OPPORTUNITY FUND I, LLC, a California limited liability company ("MKA"), MKA Capital Group Advisors, LLC ("Manager"), MICHAEL A. ABRAHAM, an individual ("Abraham") and JASON SUGARMAN ("Sugarman").

### RECITALS

A. Promissory Notes. MKA is the maker of the following promissory notes in favor of FLVQP:

(1) Promissory Note, dated October 30, 2006, in the original principal amount of \$2,000,000.00 (the "October 2006 FLVQP Note"); and

(2) Promissory Note, dated April 2, 2007, in favor of FLVQP in the original principal amount of \$3,000,000.00 (the "April 2007 FLVQP Note").

(collectively, the "FLVQP Notes"). Interest accrues on each of the FLVQP Notes at the rate of one percent (1%) per month, which interest was paid through November 2007.

B. Security Agreements. MKA executed and delivered to FLVQP the following security agreements to secure its obligations under the FLVQP Notes:

(1) Security Agreement, dated October 30, 2006, granting FLVQP a security interest in collateral as defined therein to secure MKA's obligations under the October 2006 FLVQP Note; and

(2) Security Agreement, dated April 2, 2007, granting FLVQP a security interest in collateral as defined therein to secure MKA's obligations under the April 2007 FLVQP Note;

(collectively, the "FLVQP Security Agreements").

C. Personal Guarantees. One or both of Abraham and Sugarman executed the following guarantees of the FLVQP Notes:

(1) Abraham guaranteed immediate payment by MKA of the October 2006 FLVQP Note; and

(2) Abraham and Sugarman guaranteed immediate payment by MKA of the April 2007 FLVQP Note.

D. Previous Extensions, Amounts Outstanding. At the request of MKA, FLVQP has from time to time extended the due date for payments of principal under the FLVQP Notes, such that as of January 31, 2008 (and in the absence of the execution and delivery to FLVQP of this

Agreement), the principal balances outstanding on the FLVQP Notes would be payable as follows:

<u>Note</u>	<u>Due Date</u>	<u>Principal Amount</u>
October 2006 Note	February 28, 2008	\$2,000,000
April 2007 Note	January 31, 2008	<u>\$3,000,000</u>
Total principal balance		\$5,000,000

Interest accrues on the principal balance outstanding on the FLVQP Notes at the rate of one percent (1%) per month, calculated based on a 360 day year. As of January 31, 2008, interest was accrued and unpaid through January 31, 2008 as follows:

<u>Note</u>	<u>Interest as of 1/31/2008</u>
October 2006 Note	\$40,000
April 2007 Note	<u>\$60,000</u>
Total	\$100,000

E. MKA has requested that FLVQP further extend the dates on which principal and interest are due and payable under the FLVQP Notes. FLVQP is willing to extend the due dates for payment of principal and interest under the FLVQP Notes on the terms and conditions set forth below.

#### AGREEMENT

NOW, THEREFORE, for good and valuable consideration, receipt of which is hereby acknowledged, and for the mutual benefits and covenants as set forth herein, the parties agree as follows:

1. Reaffirmation of Obligations under FLVQP Notes. MKA reaffirms the obligations to FLVQP under the FLVQP Notes and the FLVQP Security Agreements, and acknowledges that the amount and due dates of the obligations under the FLVQP Notes set forth in the Recitals are correct. All terms of the FLVQP Notes and FLVQP Security Agreements are expressly ratified, reaffirmed and remain unchanged except as modified in this Agreement.

2. Reaffirmation of Guarantee.

- (a) Abraham hereby reaffirms his guarantee of the obligations of MKA under the FLVQP Notes and further acknowledges that the amount and due dates of the obligations under the FLVQP 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 FLVQP Notes.
- (b) Sugarman hereby reaffirms his guarantee of the obligations of MKA under the April 2007 FLVQP Note and further acknowledges that the amount and

due dates of the obligations under the April 2007 FLVQP Note 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 April 2007 FLVQP Note.

3. Extension of Payment Due Dates. In the absence of the occurrence of an Event of Default (as defined in the FLVQP Notes), payments under the FLVQP Notes shall be due and payable as follows:

	<u>Original Due Date</u>	<u>New Due Date</u>	<u>Amount</u>
October 2006 FLVQP Note	February 28, 2008	March 31, 2008	\$2,000,000
April 2007 FLVQP Note	January 31, 2008	March 31, 2008	\$3,000,000

In addition, accrued and unpaid interest from December 2007 through March 2008 in the amount of \$200,000 shall be due and payable on March 31, 2008.

4. Reporting. Until all amounts due to FLVQP under the FLVQP Notes are paid in full, MKA shall, and Manager and Guarantor shall cause MKA to furnish to FLVQP:

- (a) On or before the last day of each month, a balance sheet, statement of income (or loss), and cash flow statement for MKA for the prior month, prepared in accordance with Generally Accepted Accounting Principles;
- (b) On or before Wednesday of each week, a report in a form reasonably satisfactory to FLVQP summarizing all cash receipts during the prior week, including without limitation, payments received by MKA on account of loans and investments from or with third parties; and
- (c) On or before the last day of each month, a report in a form reasonably satisfactory to FLVQP, summarizing as of the last day of the prior month each outstanding note receivable held by MKA, including the name of the borrower, the amount outstanding, a description of the collateral, the amount of all other known claims against the collateral (and the priority thereof), the most recent valuation of the collateral (including the date and source of the valuation); and
- (d) Such other financial information and reports as FLVQP may reasonably request from time to time.

5. Negative Covenants. Without the prior written consent of FLVQP, until all amounts due to FLVQP are paid in full, MKA shall not:

- (a) Make or contract to make capital expenditures, including leasehold improvements, or incur liability for rentals of property (including both real and personal property);
- (b) Create, incur or assume additional indebtedness except for trade debt incurred in the normal course of business and indebtedness to FLVQP contemplated by this Agreement;
- (c) Cease operations, liquidate, merge, transfer, acquire or consolidate with any other entity, change ownership, dissolve or transfer or sell assets out of the ordinary course of business;
- (d) Declare or make any dividend payment or other distribution of assets, property, cash, rights, obligations, or securities on account of any equity interests in MKA, or purchase, redeem, retire or otherwise acquire for value any equity interest in MKA, including without limitation, make any "Tier 1" or "Tier 2" distributions to holders of interests in MKA;
- (e) Loan, invest in or advance money or assets, purchase, create or acquire any interest in any other enterprise or entity, or incur any obligation as surety or guarantor;
- (f) Except for reimbursements to Manager of out of pocket expenses incurred in the ordinary course of business, make any payments to MKA Offshore or any affiliate of MKA, Manager or Guarantor; or
- (g) Make any payments outside of the ordinary course of business of MKA other than (i) payments to Gottex Fund Management Limited, as agent for the benefit of Gottex ABI Master Fund Limited, Gottex ABL (Cayman) Limited, GVA ABL Portfolio Limited, Hudson ABL Fund Limited (collectively, the "Gottex Funds"), on account of notes outstanding as of the date hereof.

6. MKA, Manager and Guarantor Representations and Warranties. MKA, Manager, and Guarantor represent and warrant to FLVQP as of the Effective Date:

- (a) Each of MKA, the Manager and Guarantor; and the persons signing on behalf of each of them, has full power and authority to execute this Agreement and perform its obligations hereunder;
- (b) The execution, delivery and performance of this Agreement by MKA, Manager and Guarantor have been fully and validly authorized; and all requisite corporate or other action has been taken by MKA, Manager, and Guarantor to make this Agreement valid and binding upon MKA, Manager and Guarantor and enforceable in accordance with its terms; and
- (c) All financial information provided to FLVQP (including without limitation all financial statements provided pursuant to paragraph 5, above) is true and correct in all respects as of the date provided to FLVQP.

7. Guarantor Financial Statement. On or before March 4, 2008, Guarantor shall provide FLVQP with a financial statement setting forth his assets and liabilities, as of December 31, 2007, along with a statement of any material changes since that date.

8. Effective Date. This Agreement shall become effective on the date (the "Effective Date") on which each of MKA, Manager and Guarantor has properly executed and delivered to FLVQP this Agreement.

9. Assignment of FLVQP Notes Upon Payment in Full. Upon or following payment in full of the FLVQP Notes, at the request of MKA, FLVQP shall cause any holder of the FLVQP Notes, at no cost to FLVQP or any such holder, to take any and all steps reasonably necessary to assign the FLVQP Notes to a third party identified by MKA, including, without limitation, delivering such documents as are reasonably necessary or appropriate to effect such assignment of the FLVQP Notes, provided however, that such assignment shall be on an as is, where is basis and without recourse to FLVQP, and FLVQP shall not incur any liability in connection with such assignment, or be required to make any representations or warranties (other than customary warranties of due authorization and no encumbrance of title to such note) to any assignee, MKA, or any other third party in connection with such assignment.

10. Fees and Expenses. MKA agrees to pay FLVQP on demand, and Guarantor acknowledges that his guarantee includes the obligation to pay to FLVQP, all fees and expenses, including, without limitation, reasonable attorneys' fees and disbursements, incurred by FLVQP (a) in all efforts made to enforce payment of any of the obligations under the FLVQP Notes, the FLVQP Security Agreements, this Agreement, or any other instrument or agreement between MKA and FLVQP, or (b) in connection with the modification, amendment, administration and enforcement of the obligations under the FLVQP Notes, the FLVQP Security Agreements, this Agreement, or any instrument or agreement between MKA and FLVQP, or (c) in any dispute relating to the interpretation, enforcement or performance of the FLVQP Notes, the FLVQP Security Agreements, this Agreement, or any instrument or agreement between MKA and FLVQP, in any event whether through judicial proceedings, including bankruptcy, or otherwise.

11. Release by MKA, Manager, and Guarantors. In consideration for FLVQP's agreement to enter into this Agreement, each of MKA, Manager and Guarantor (each, a "Releasor") releases and forever discharges FLVQP and Freestone Investments, LLC, their predecessors and successors in interest, and their respective directors, officers, employees, representatives and agents from any and all claims, damages, liabilities, obligations, actions and causes of action, whether sounding in tort, contract, equity or otherwise, whether known or unknown, whether suspected or unsuspected, and whether arising directly in favor of the Releasor, or by way of assignment, subrogation, or indemnification held by the Releasor, and all of the foregoing as may have arisen from any act, failure to act, event or state of facts occurring on or prior to the Effective Date.

12. Section 1542 Waiver. Releasors waive and relinquish, to the fullest extent that the law permits, the provisions, rights, and benefits of California Civil Code § 1542 and other statutes or common law principles of similar effect. Releasors acknowledge that they are familiar with, and/or have been advised by their legal counsel of, the provisions of California Civil Code § 1542, which provides as follows:

[Certain claims not affected by general release.] A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.

13. Acknowledgment and Consideration. MKA and Guarantors hereby acknowledge and warrant that the forbearance and extension of the maturity date by FLVQP hereunder constitutes fair, adequate and contemporaneous exchange of consideration for the performance of their promises pursuant to the terms of this Agreement.

14. No Waiver, Remedies Cumulative. No failure by FLVQP to exercise, and no delay in exercising, any right, power or remedy under the FLVQP Notes, the FLVQP Security Agreements, this Agreement or any related document shall operate as a waiver thereof, nor shall any single or partial exercise of any right, power or remedy under the FLVQP Notes, the FLVQP Security Agreements, this Agreement or any related document preclude any other or further exercise thereof or the exercise of any other right, power, or remedy. The rights and remedies provided herein and therein are cumulative and not exclusive of any right or remedy provided by law.

15. Entire Agreement; Amendment. Except as otherwise stated, this Agreement supersedes any prior arrangements and includes all understandings of the parties with regard to the extension of new credit and forbearance from collection of any obligations or the enforcement of the FLVQP Notes or the FLVQP Security Agreements. Any and all changes to this Agreement must be in writing and signed by all the parties. The parties agree to execute properly and promptly and to deliver any additional documents, and to do all reasonable things that may be necessary or appropriate to render this Agreement legally and practically effective.

16. Counterparts. This Agreement or the signature pages hereto may be executed in any number of counterparts for the convenience of the parties, all of which, when taken together and after execution by all parties hereto, shall constitute one and the same agreement.

17. Independent Legal Advice. Each of MKA, Manager and Guarantors has had the opportunity to seek advice of independent legal counsel of his or its choice in connection with this Agreement, and the agreements and transactions contemplated herein.

18. No Representations or Warranties by FLVQP. Except as expressly set forth herein, FLVQP makes no representations, warranties, promises, or commitments to loan money, extend credit, or forbear from enforcing repayment in connection with any of the documents or transactions contemplated hereunder. Each of MKA, Manager and Guarantor acknowledges that he or it has received the following notice:

**ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.**

*{Remainder of Page Intentionally Left Blank}*

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS L.P.  
By Freestone Investments, LLC

By: *Ken Miyoshi*  
Name: *Ken Miyoshi*  
Title: *Member, Freestone Investments LLC*

MKA REAL ESTATE OPPORTUNITY FUND I, LLC  
By MKA Capital Group Advisors, LLC

By: \_\_\_\_\_  
Name:  
Title:

By MKA CAPITAL GROUP ADVISORS, LLC

By: \_\_\_\_\_  
Name:  
Title:

\_\_\_\_\_  
MICHAEL A. ABRAHAM

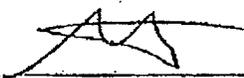
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JASON SUGARMAN

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

**FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS L.P.**  
By Freestone Investments, LLC

By: \_\_\_\_\_  
Name:  
Title:

**MKA REAL ESTATE OPPORTUNITY FUND I, LLC**  
By MKA Capital Group Advisors, LLC

By:   
Name: GREGOR COJOW  
Title: PRESIDENT

By MKA CAPITAL GROUP ADVISORS, LLC

By: \_\_\_\_\_  
Name:  
Title:

\_\_\_\_\_  
MICHAEL A. ABRAHAM

\_\_\_\_\_  
JASON SUGARMAN

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

FREESTONE LOW VOLATILITY QUALIFIED PARTNERS L.P.  
By Freestone Investments, LLC

By: \_\_\_\_\_  
Name:  
Title:

MKA REAL ESTATE OPPORTUNITY FUND I, LLC  
By MKA Capital Group Advisors, LLC

By: \_\_\_\_\_  
Name:  
Title:

By MKA CAPITAL GROUP ADVISORS, LLC

By: Michael A. Abraham  
Name: MICHAEL ABRAHAM  
Title: CHAIRMAN OF THE BOARD

Michael A. Abraham  
MICHAEL A. ABRAHAM

Jason Sugarman  
JASON SUGARMAN

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS L.P.

By Freestone Investments, LLC

By: \_\_\_\_\_

Name:

Title:

MKA REAL ESTATE OPPORTUNITY FUND I, LLC

By MKA Capital Group Advisors, LLC

By: \_\_\_\_\_

Name:

Title:

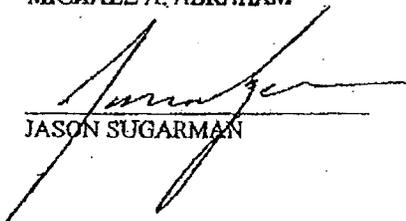
By MKA CAPITAL GROUP ADVISORS, LLC

By: \_\_\_\_\_

Name:

Title:

\_\_\_\_\_  
MICHAEL A. ABRAHAM

  
\_\_\_\_\_  
JASON SUGARMAN



## SUBORDINATION AGREEMENT

This Subordination Agreement (the "Agreement") is made and entered into on this 20<sup>th</sup> day of February, 2007, among Freestone Capital Partners L.P., Freestone Capital Qualified Partners L.P., Freestone Low Volatility Partners LP, Freestone Low Volatility Qualified Partners LP (collectively, the "Creditor"), Gottex Fund Management Ltd., as administrative agent (the "Administrative Agent") to GVA ABL Portfolio Limited, Gottex ABL (Cayman) Limited (collectively, the "Original Noteholders") and Gottex ABI Master Fund Limited (the "New Noteholder" and collectively with the Original Noteholders, the "Noteholders") and MKA Real Estate Opportunity Fund I, LLC, a California limited liability company (together with its successors and assigns, "Borrower").

WHEREAS, each of the Original Noteholders purchased one or more secured registered promissory notes in an aggregate principal amount of \$60,000,000; and

WHEREAS, it is a condition precedent to the New Noteholder agreeing to purchase a secured promissory note from Borrower (the "New Note") that Creditor enter into this Agreement.

NOW, THEREFORE, to induce the New Noteholder to purchase the New Note, and for other valuable consideration, receipt of which is hereby acknowledged, the parties to this Agreement, intending to be legally bound hereby, agree as follows:

1. All obligations of Borrower, howsoever created, arising or evidenced, whether as principal obligor, guarantor, surety, accommodation party, or otherwise, direct or indirect, absolute or contingent or now or hereafter existing or due or to become due are hereinafter called "Liabilities." "Senior Liabilities" means all Liabilities to the Noteholders, the aggregate principal amount of which shall not exceed \$135,000,000, including, but not limited to (i) those Liabilities arising pursuant to or in connection with each secured registered promissory note purchased by a Noteholder from Borrower from time to time (collectively, the "Notes"), and all documents required to be executed or delivered pursuant thereto or in connection therewith (collectively with the Notes, the "Facility Documents") and (ii) any and all interest accruing on any of the Senior Liabilities after the commencement of any proceedings referred to in paragraph 3 hereof, notwithstanding any provision or rule of law which might restrict or otherwise impair the rights of the Noteholders, as against Borrower or anyone else, to collect such interest. "Junior Liabilities" means all Liabilities to the Creditor now and hereafter existing. Each of Creditor and Borrower agree that, to the extent and manner hereinafter set forth, the repayment to Creditor of all or any portion of the Junior Liabilities is, and shall at all times be, subordinate to the prior indefeasible payment in full of all of the Senior Liabilities. For purposes of this Agreement, the Senior Liabilities shall not be deemed to have been paid in full until the Noteholders shall have been indefeasibly paid in full by Borrower in United States dollars.

2. The payment of principal of (and premium, if any) and interest and other payment obligations in respect of the Junior Liabilities shall be subordinate to the prior payment in full of the Senior Liabilities to the extent that no payments of principal of (or premium, if any)

or interest on, or otherwise due in respect of such Junior Liabilities, may be permitted for so long as any default on the Senior Liabilities exists.

3. In the event of any dissolution, winding up, liquidation, readjustment, reorganization or other similar proceedings relating to Borrower or to its creditors, as such, or to its property (whether voluntary or involuntary, partial or complete, and whether in bankruptcy, insolvency, or receivership, or upon an assignment for the benefit of creditors, or any other marshalling of the assets and liabilities of Borrower, or any sale of all or substantially all of the assets of Borrower, or otherwise), the Senior Liabilities shall first be indefeasibly paid in full before Creditor shall be entitled to receive and to retain any payment or distribution in respect of the Junior Liabilities (other than membership interests of Borrower as reorganized or readjusted, or debt securities of Borrower or any other entity provided for by a plan of reorganization or adjustment, which securities are subordinated to the payment of the Senior Liabilities and securities received in lieu thereof which may at the time be outstanding (collectively, the "Permitted Securities"), and, in order to effect the foregoing (a) all payments and distributions of any kind or character in respect of the Junior Liabilities (other than Permitted Securities) to which Creditor would be entitled if the Junior Liabilities were not subordinated, or subordinated and pledged or assigned, pursuant to this Agreement shall be made directly to the Noteholders, (b) Creditor shall promptly file a claim or claims, in the form required in such proceedings, for the full outstanding amount of the Junior Liabilities, and shall cause said claim or claims to be approved and all payments and other distributions in respect thereof other than Permitted Securities to be made directly to the Noteholders, and (c) Creditor hereby irrevocably agrees that the Noteholders may, at its sole discretion, in the name of Creditor or otherwise, demand, sue for, collect and receive any and all such payments or distributions (other than with respect to any Permitted Securities).

4. Notwithstanding anything herein to the contrary, Creditor will forbear any action against Borrower for the collection or payment of the Junior Liabilities until such time as the Senior Liabilities have been fully and indefeasibly paid, satisfied and discharged.

5. If, after an Event of Default (as defined in the Notes) has been declared by a Noteholder, all applicable cure periods with respect to the relevant Event of Default have expired and Creditor has been notified of such declaration, Creditor receives any payment or other distribution of any kind or character from Borrower or any other source whatsoever in respect of any of the Junior Liabilities, other than as expressly permitted by the terms of this Agreement, such payment or other distribution shall be received in trust for the Noteholders and promptly turned over by Creditor to the Administrative Agent, together with all necessary and appropriate endorsements thereto. Creditor will mark its books and records, and cause Borrower to mark its books and records, so as to clearly indicate that the Junior Liabilities are subordinated in accordance with the terms of this Agreement, and will cause any promissory note or other instrument which at any time evidences any of the Junior Liabilities to be conspicuously marked as follows:

This instrument is subject to the terms of a Subordination Agreement by and among Freestone Capital Partners L.P., Freestone Capital Qualified Partners L.P., Freestone Low Volatility Partners LP, Freestone Low Volatility Qualified Partners LP, Gottex Fund Management Ltd., and MKA

**Real Estate Opportunity Fund I, LLC. Notwithstanding any contrary statement contained in this instrument, no payment on account of principal or interest thereof shall be received by the holder except in accordance with the terms of such Subordination Agreement.**

Creditor will execute such further documents or instruments and take such further action as the Noteholders may reasonably request from time-to-time in order to carry out the intent of this Agreement.

6. Creditor shall not, without the prior written consent of the Noteholders, exercise any rights of Creditor as a secured party, with respect to the enforcement of its rights as a secured party, until all of the obligations to the Noteholders have been satisfied in full. Creditor hereby subordinates any and all security interests which Creditor now has or hereafter acquires in any assets of MKA, to the security interests of the Administrative Agent, as agent to the Noteholders, which the Administrative Agent now has or hereafter acquires, in any and all of the assets of MKA (the "Collateral"). The subordination and priorities specified herein are applicable irrespective of the time or order of attachment or perfection of the security interests referred to herein and the time or order of filing of financing statements. The Administrative Agent's claim, on behalf of the Noteholders, to proceeds realized or received by MKA from the sale, collection, liquidation or other disposition of Collateral shall have priority over Creditor's claim to such proceeds. Any proceeds received by Creditor with respect to the enforcement of its security interest in contravention of this Agreement shall be deemed to have been collected or received by Creditor as trustee for the Noteholders and shall be paid over to the Administrative Agent, on behalf of the Noteholders, on account of the obligations due and owing by Borrower to the Noteholders. Creditor agrees not to permit any of the terms of the Junior Liabilities to be changed in a manner adverse to the Noteholders' interest under this Agreement, without the prior written consent of the Noteholders. The parties hereby agree that if a Noteholder declares an Event of Default (as defined in the Notes) under any Note, Freestone shall have the right to declare an event of default, default, or the like, under its loan agreement, or the like, with MKA.

7. Creditor agrees not to assign or transfer the Junior Liabilities without (a) prior notice to the Noteholders, and (b) written agreement by the assignee or transferee to be bound by the terms of this Subordination Agreement.

8. This Agreement shall in all respects be a continuing agreement and shall remain in full force and effect until the Senior Liabilities shall have been indefeasibly paid in full.

9. The Noteholders may, from time-to-time, whether before or after any discontinuance of this Agreement, at its sole discretion and without notice to Creditor, take any or all of the following actions: (a) retain or obtain a security interest in any property of Borrower to secure any of the Senior Liabilities, (b) extend or renew for one or more periods (whether or not longer than the original period), alter or exchange any of the Senior Liabilities, or release or compromise any obligation of any nature of any obligor with respect to any of the Senior Liabilities, and (c) release its security interest in, or surrender, release or permit any substitution or exchange for, all or any part of any property securing any of the Senior Liabilities, or extend or renew for one or more periods (whether or not longer than the original period) or release,

compromise, alter or exchange any obligations of any nature of any obligor with respect to any such property.

10. The Noteholders may, from time-to-time, whether before or after any discontinuance of this Agreement, assign or transfer any or all of the Senior Liabilities or any interest therein; and, notwithstanding any such assignment or transfer thereof, such Senior Liabilities shall be and remain Senior Liabilities for the purposes of this Agreement, and every immediate and successive assignee or transferee of any of the Senior Liabilities or of any interest therein shall, to the extent of the interest of such assignee or transferee in the Senior Liabilities, be entitled to the benefits of this Agreement to the same extent as if such assignee or transferee were the Noteholders; provided, however, that, unless the Noteholders shall otherwise consent in writing, the Noteholders shall have an unimpaired right, prior and superior to that of any such assignee or transferee, to enforce this Agreement, for the benefit of the Noteholders, as to those of the Senior Liabilities which the Noteholders has not assigned or transferred. The parties hereby agree that any assignee or transferee of all or any portion of the Senior Liabilities, or any interest therein, shall be, irrevocably, third party beneficiaries of this Agreement. For the avoidance of doubt, Gottex shall notify Creditor prior to making any such transfer or assignment, as the case may be.

11. The Noteholders shall not be prejudiced in its right under this Agreement by any act or failure to act of Borrower or Creditor, or any noncompliance of Borrower or Creditor with any agreement or obligation, regardless of any knowledge thereof which the Noteholders may have or with which the Noteholders may be charged; and no action of the Noteholders permitted hereunder shall in any way affect or impair the rights of the Noteholders and the obligations of Creditor under this Agreement.

12. No delay on the part of the Noteholders in the exercise of any right or remedy shall preclude other or further exercise thereof or the exercise of any other right or remedy; nor shall any modification or waiver of any of the provisions of this Agreement be binding upon the Noteholders except as expressly set forth in a writing duly signed and delivered on behalf of the Noteholders.

13. The provisions of this Agreement are solely for the purposes of defining the relative rights of the holder of Junior Liabilities and the holders of Senior Liabilities. Nothing contained in this Agreement is intended to or shall impair, as between Borrower and the holder of the Junior Liabilities, the obligation of Borrower to pay the Junior Liabilities as and when the same shall become due and payable in accordance with their terms, nor shall anything herein prevent the holder of the Junior Liabilities from exercising all remedies otherwise permitted by applicable law or under or with respect to the Junior Liabilities upon default, subject to the restrictions set forth in this Agreement and the rights, if any, under this Agreement of the holders of Senior Liabilities in respect of cash, property, or securities (other than Permitted Securities) of Borrower received upon the exercise of any such remedy.

14. This Agreement shall be binding upon Creditor and upon its personal representatives, successors and assigns.

15. This Agreement shall be construed in accordance with and governed by the laws of the State of New York (without regard to its conflicts of laws principles). Wherever possible each provision of this Agreement shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Agreement shall be enjoined by or invalid under such law, such provision shall be ineffective to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Agreement.

16. Creditor shall provide the Noteholders with written notice of any default by Borrower under the Junior Liabilities contemporaneously with the giving of such notice to Borrower. Upon the declaration of any Event of Default (as defined in the Notes) under a Note, the Administrative Agent shall provide Creditor with prompt written notice of such declaration.

17. Borrower shall indemnify the Administrative Agent, the Noteholders, their respective agents, employees, affiliates, officers and directors (each, an "Indemnitee") against, and hold each Indemnitee harmless from, any and all losses, claims, damages, liabilities and related expenses (including the fees, charges and disbursements of any counsel for any Indemnitee) incurred by any Indemnitee or asserted against any Indemnitee by any third party or by Borrower or any of its affiliates, arising out of, in connection with, or as a result of (i) the execution or delivery of this Agreement, any or any agreement or instrument contemplated hereby or thereby, the performance by the parties hereto of their respective obligations hereunder or thereunder or the consummation of the transactions contemplated hereby or thereby, or (ii) any actual or prospective claim, litigation, investigation or proceeding relating to any of the foregoing, whether based on contract, tort or any other theory, whether brought by a third party or by Borrower or any of its affiliates, and regardless of whether any Indemnitee is a party thereto, provided that such indemnity shall not, as to any Indemnitee, be available to the extent that such losses, claims, damages, liabilities or related expenses (x) are determined by a court of competent jurisdiction by final and nonappealable judgment to have resulted from the gross negligence or willful misconduct of such Indemnitee or (y) result from a claim brought by Borrower or any affiliate thereof against an Indemnitee for breach in bad faith of such Indemnitee's obligations hereunder, if Borrower or such affiliate has obtained a final and nonappealable judgment in its favor on such claim as determined by a court of competent jurisdiction.

18. This Agreement may be signed in counterparts each of which shall be an original and all of which, when taken together, shall constitute one and the same instrument. Delivery of an executed counterpart of a signature page of this Agreement by facsimile shall be effective as delivery of a manually executed counterpart of this Agreement.

19. Each of Gottex and Borrower hereby represent, warrant and covenant that the aggregate principal amount outstanding under the Notes shall not exceed \$135,000,000.

[SIGNATURE PAGE TO FOLLOW]

IN WITNESS WHEREOF, this Subordination Agreement has been entered into as of this  
day of February, 2007.

GOTTEX FUND MANAGEMENT LTD.

By: [Signature]  
Name: William H. Macpherson  
Title: Managing Director

MKA REAL ESTATE OPPORTUNITY FUND I,  
LLC

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE CAPITAL PARTNERS L.P.

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE CAPITAL QUALIFIED  
PARTNERS L.P.

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE LOW VOLATILITY PARTNERS  
LP

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS LP

By: \_\_\_\_\_  
Name:  
Title:

2<sup>nd</sup> IN WITNESS WHEREOF, this Subordination Agreement has been entered into as of this  
day of February, 2007.

GOTTEX FUND MANAGEMENT LTD.

By: \_\_\_\_\_  
Name:  
Title:

MKA REAL ESTATE OPPORTUNITY FUND I,  
LLC

*8-1. MKA CAPITAL GROUP ADVISORS LLC  
K.S. Manager*

By: *[Signature]*  
Name: *Jessie Monahan*  
Title: *CEO*

FREESTONE CAPITAL PARTNERS L.P.

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE CAPITAL QUALIFIED  
PARTNERS L.P.

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE LOW VOLATILITY PARTNERS  
LP

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE LOW VOLATILITY QUALIFIED  
PARTNERS LP

By: \_\_\_\_\_  
Name:  
Title:

IN WITNESS WHEREOF, this Subordination Agreement has been entered into as of this 20<sup>th</sup> day of February, 2007.

GOTTEX FUND MANAGEMENT LTD.

By: \_\_\_\_\_  
Name:  
Title:

MKA REAL ESTATE OPPORTUNITY FUND I, LLC

By: \_\_\_\_\_  
Name:  
Title:

FREESTONE CAPITAL PARTNERS L.P.

By: Ken Miyoshi  
Name: Ken Miyoshi  
Title: Member of the General Partner

FREESTONE CAPITAL QUALIFIED PARTNERS L.P.

By: Ken Miyoshi  
Name: Ken Miyoshi  
Title: Member of the General Partner

FREESTONE LOW VOLATILITY PARTNERS LP

By: Ken Miyoshi  
Name: Ken Miyoshi  
Title: Member of the General Partner

FREESTONE LOW VOLATILITY QUALIFIED PARTNERS LP

By: Ken Miyoshi  
Name: Ken Miyoshi  
Title: Member of the General Partner



LEXSTAT CAL CIV CODE 1646

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Part 2. Contracts  
Title 3. Interpretation of Contracts

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

*Cal Civ Code § 1646 (2011)*

**§ 1646. Law of place**

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.

**HISTORY:**

Enacted 1872.

LEXSTAT CAL CIV CODE 2787

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Title 13. Suretyship  
Article 1. Definition of Suretyship

**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2787 (2010)*

**§ 2787. Former distinctions abolished; Surety or guarantor defined; Guaranties of collection; Continuing guaranties**

The distinction between sureties and guarantors is hereby abolished. The terms and their derivatives, wherever used in this code or in any other statute or law of this state now in force or hereafter enacted, shall have the same meaning as defined in this section. A surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor. Guaranties of collection and continuing guaranties are forms of suretyship obligations, and except in so far as necessary in order to give effect to provisions specially relating thereto, shall be subject to all provisions of law relating to suretyships in general. A letter of credit is not a form of suretyship obligation. For purposes of this section, the term "letter of credit" means a "letter of credit" as defined in paragraph (10) of subdivision (a) of *Section 5102 of the Commercial Code* whether or not the engagement is governed by Division 5 (commencing with *Section 5101*) of the *Commercial Code*.

**HISTORY:**

Enacted 1872. Amended Stats 1939 ch 453 § 10; Stats 1994 ch 611 § 1 (SB 1612), effective September 15, 1994; Stats 1996 ch 176 § 1 (SB 1599).

LEXSTAT CAL CIV CODE 2806

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Article 4. Liability of Sureties

GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

*Cal Civ Code § 2806 (2010)*

**§ 2806. Construction of suretyship obligation**

A suretyship obligation is to be deemed unconditional unless its terms import some condition precedent to the liability of the surety.

**HISTORY:**

Enacted 1872. Amended Stats 1939 ch 453 § 17.

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Article 4. Liability of Sureties

**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2807 (2010)*

**§ 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.

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GO TO CALIFORNIA CODES ARCHIVE DIRECTORY

*Cal Civ Code § 2809 (2010)*

**§ 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.

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*Cal Civ Code § 2810 (2010)*

**§ 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.

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Article 6. Exoneration of Sureties

**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2819 (2010)*

**§ 2819. Acts operating to exonerate generally**

A surety is exonerated, except so far as he or she may be indemnified by the principal, if by any act of the creditor, without the consent of the surety the original obligation of the principal is altered in any respect, or the remedies or rights of the creditor against the principal, in respect thereto, in any way impaired or suspended. However, nothing in this section shall be construed to supersede subdivision (b) of Section 2822.

**HISTORY:**

Enacted 1872. Amended Stats 1939 ch 453 § 22; Stats 1993 ch 149 § 1 (AB 1402), effective July 16, 1993.

*Cal Civ Code § 2822*

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**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

Cal Civ Code § 2822 (2010)

**§ 2822. Acceptance of part performance**

(a) The acceptance, by a creditor, of anything in partial satisfaction of an obligation, reduces the obligation of a surety thereof, in the same measure as that of the principal, but does not otherwise affect it. However, if the surety is liable upon only a portion of an obligation and the principal provides partial satisfaction of the obligation, the principal may designate the portion of the obligation that is to be satisfied.

(b) For purposes of this section and Section 2819, an agreement by a creditor to accept from the principal debtor a sum less than the balance owed on the original obligation, without the prior consent of the surety and without any other change to the underlying agreement between the creditor and principal debtor, shall not exonerate the surety for the lesser sum agreed upon by the creditor and principal debtor.

**History:**

Enacted 1872. Amended Stats 1939 ch 453 § 23; Stats 1993 ch 149 § 2 (AB 1402), effective July 16, 1993.

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**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2823 (2010)*

**§ 2823. Delay in proceeding against principal**

Mere delay on the part of a creditor to proceed against the principal, or to enforce any other remedy, does not exonerate a surety.

**HISTORY:**

Enacted 1872. Amended Stats 1939 ch 453 § 25.

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**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2845 (2010)*

**§ 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 2849

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*Cal Civ Code § 2849 (2011)*

**§ 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.

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**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**

*Cal Civ Code § 2850 (2010)*

**§ 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.

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**GO TO CALIFORNIA CODES ARCHIVE DIRECTORY**  
  
*Cal Civ Code § 2856 (2010)*

**§ 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).



Conflict of Laws than in most other areas of the law, and it seems probable that this trend will continue. As experience accumulates, some existing Conflict of Laws rules may be modified and additional rules may be devised in order to cover narrower situations with greater precision and definiteness. The extent to which there have been changes in Conflict of Laws rules since the appearance of the original Restatement of this Subject is indicated in the various Sections and in the Reporter's Notes.

*d. Underlying policies.* The policies reflected by Conflict of Laws rules are essentially of two kinds: those which underlie the particular local law rules at issue and those which underlie multistate situations in general. An important objective in any choice-of-law case is to accommodate in the best way possible the policies underlying the potentially applicable local law rules of the states involved. Since multistate situations give rise to peculiar policies of their own, Conflict of Laws rules should reflect these policies.

Important factors underlying rules of choice of law are discussed in § 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.

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See Appendix for Court Citation and Cross References

**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.

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**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

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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 domicile, 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'

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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

*Comment h:* The cases generally support the view that it is the local law of the state chosen by the parties that should be applied. Two exceptional cases to the contrary are *Duskin v. Pennsylvania Central Airlines Corp.*, supra, and *Vita Food Products, Inc. v. Unus Shipping Co., Ltd.*, supra.

*Comment i:* For a case suggesting that the parties may choose a special law to govern the validity of an arbitration clause contained in an agreement, see *Matter of Electronic & Missile Facilities, Inc.*, N.Y.L.J. 12/26/62, p. 10, col. 5.

**§ 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 domicile, 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.

**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).

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See Appendix for Court Citation and Cross References

**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 hap-

pens 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

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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 domicil, 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 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

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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*

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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.

#### REPORTER'S NOTE

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*, 289 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, Massa-

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chusetts 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. Gohwynne 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 domicile, 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 423, 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, 536, 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. 153, 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

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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); *Wojeiuk 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"); *Pottlatch No. 1 Federal Credit Union v. Kennedy*, — Wash.2d —, 459 P.2d 92 (1969) (quoting and applying rule of Section); *Baffin Land Corp. v. Monticello Motor Inn, Inc.*, 70 Wash.2d 398, 425 P.2d 623 (1967) (quoting and applying rule as stated in § 382 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*.

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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).

#### TITLE B. PARTICULAR CONTRACTS

**Introductory 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. Except as stated in §§ 192-193, a choice of law by the parties will be effective, under the circumstances stated in § 187, in the case of the contracts discussed in this Title.

#### § 189. Contracts for the Transfer of Interests in Land

The validity of a contract for the transfer of an interest in land 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 land is situated 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.

##### Comment:

*a. Distinction between contract and transfer.* A distinction must here be drawn between a contract for the transfer of an interest in land and the actual transfer of such an interest. The validity of a contract for the transfer of an interest in land, and the rights created thereby, are determined by the local law of the state selected by application of the rule of this Section. On the other hand, whether the contract operates as an actual

Contracts of marine insurance are usually governed by federal law, but federal law may turn to State local law for the rule of decision. *Wilburn Boat Co. v. Fireman's Ins. Co.*, 348 U.S. 310 (1955).

See generally Patterson, *Essentials of Insurance Law* § 10 (1957); 3 Rabel, *Conflict of Laws* 341-343 (1950); Lenthoff, *Conflict Avoidance in Insurance*, 21

*Law & Contemp. Prob.* 549 (1956); Rabel, *Conflicts Rules on Contracts*, in *Lectures on the Conflict of Laws and International Contracts* (1951). For a review of the cases dealing with conflict of laws relating to automobile liability insurance, see Risjord, *Conflict of Laws Applicable to the Standard Automobile Liability Policy*, 1957 *Wis.L.Rev.* 536.

#### § 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.

##### 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.

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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).

#### REPORTER'S NOTE

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