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DIVISION II

NO. 37541-9-II

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STATE OF WASHINGTON
DEPUTY

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

MATTHEW SMITH COMPANY, INC.,

Plaintiffs/Respondents

vs.

DONALD C. CHILL,

Defendant/Appellant

APPEAL FROM THE SUPERIOR COURT

THE HONORABLE ROGER A. BENNETT

REPLY BRIEF

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INTRODUCTION

A Reply Brief properly deals with points raised in the Brief of Respondent and should avoid repeating arguments made in the Brief of Appellant. RAP 10.3(c) This brief will adhere to those rules. Matters not addressed in this brief that were appropriately covered in the Brief of Appellant will not be repeated.

ERRATA

The Brief of Appellant cited 12A *Blue Sky Law* 19:188, 19:198 at Page 30. That citation was incorrect. The property citation is 12A *Blue Sky Law* 9:188, 9:198. Counsel regrets this error.

REPLY

I. Assignments of Error Nos. 1 and 2.

a. Introduction.

The arguments made by Matthew Smith Company on these points have no merit. Matthew Smith Company has incorrectly stated the facts and the applicable law.

b. The Mere Fact That an Award Was Made Does Not Mean That the Arbitrators Were Authorized to Make That Award.

Relying on *Boyd v. Davis*, 127 Wn.2d 256, 897 P.2d 1239 (1995), Matthew Smith Company asserts that the fact that the arbitrators

purported to affect rights under the \$1 million Promissory Note, the Commercial Lease, the Executive Employment Agreement, and the agreement concerning account receivables that they had authority to do so. That simply is not an appropriate reading of *Boyd v. Davis, supra*, or an accurate statement of the law. The arbitrators may only decide matters that the parties have agreed to arbitrate. *Tacoma Narrows Contractors v. Nippon Steel-Kawada Bridge, Inc.*, 138 Wn.App. 203, 213, 156 P.3d 293 (2007); *Nelson v. Westport Shipyard, Inc.*, 140 Wn.App. 102, 163 P.3d 807 (2007). If the fact that the arbitrators made an award on a subject was sufficient proof that the parties agreed to arbitrate the question, then any arbitrator could go off on any frolic regardless of the parties' arbitration agreement. That is simply not the law.

Matthew Smith Company also appears to contend that *Boyd v. Davis, supra*, gives arbitrators unfettered authority to address other agreements the parties may have made that do not contain an arbitration clause. The facts of *Boyd v. Davis, supra*, however, clearly belie that assertion. That case dealt with an arbitrator's decision arising out of the sale of a medical practice. The parties had executed an Asset Sale Agreement, an Option Agreement, a Security Agreement, a Lease, and an Employment Agreement and Covenant Not to Compete. The Supreme Court opinion does not discuss the nature of the arbitration agreements

between the parties. The Court of Appeals' opinion does, however, as follows:

Here, it is undisputed that the controversy was subject to arbitration and the arbitration clauses of the sale and employment agreements utilizing essentially identical language containing no exclusion of any sort; in fact they are broad and inclusive requiring arbitration of "any claim or controversy arising out of or relating to this Agreement."

Boyd v. Davis, 75 Wn.App. 23, 27 (1994).

The Court of Appeals' opinion in *Boyd v. Davis*, tells us that the parties agreed that the arbitrator had the authority to make rulings concerning all the agreements. That is not the case here. Mr. Chill explicitly refused to arbitrate matters concerning the \$1 million Promissory Note; the Commercial Lease; the Executive Employment Agreement; or the agreement concerning accounts receivable. (CP 140) He filed suit to address matters stemming from those agreements. He had no idea that Matthew Smith Company sought to affect those agreements in the arbitration until January 8, 2008, over one month after the arbitration hearing had been completed and during the course of discussions concerning the form of the arbitration award.

Furthermore, our arbitration clause is narrower than that in *Boyd v. Davis*. The only arbitration clause is contained in the Stock

Purchase Agreement. It allows for arbitration of disputes arising out of that agreement. The language of the arbitration clauses in *Boyd v. Davis* “arising of or related to” the agreement is significantly broader. (Brief of Appellant, pps. 20-3)

Matthew Smith Company also appears to invoke dictum in *Keen v. IFG Leasing Co*, 28 Wn.App. 167, 622 P.2d 861 (1980) and *Hanson v. Shim*, 87 Wn.App. 538, 943 P.2d 322 (1997), concerning the alleged breadth of arbitrators’ powers. The comments of the respective courts in those opinions must be gauged in light of the arbitration agreements the courts were interpreting. In *Keen v. IFG Leasing Co*, *supra*, the parties agreed to arbitrate “any controversy or claim arising out of or relating to this contract or the breach thereof.” 28 Wn.App. at 169. In *Hanson v. Shim*, *supra*, the agreement provided for arbitration of “any controversy, claim or dispute arising out of or relating to this Agreement or the breach thereof.” 87 Wn.App. at 550. In other words, the arbitration agreements there were considerably broader than that here.

c. Mr. Chill Did Not Agree to Allow the Arbitrators to Affect Other Agreements.

The arbitration demand dated June 28, 2007, refers only to the Stock Purchase Agreement. It contains no reference to the \$1 million Promissory Note, the Commercial Lease, the Executive Employment

Agreement, or the agreement concerning accounts receivable. Counsel for Matthew Smith Company specifically asked to arbitrate other matters between the parties. Counsel for Mr. Chill refused to do so and suggested that the parties forego arbitration to have all disputes combined so that all matters could be resolved in court. (CP 16-17) Mr. Chill then filed suit in Clark County Superior Court on July 9, 2007. Matthew Smith Company later expressed a desire to apply RCW 21.20 to the claims set out in its arbitration demand. Once again, it gave no indication prior to January 8, 2008, that it intended to affect other agreements.

The facts simply do not support the notion that Mr. Chill somehow agreed to allow the arbitrators to affect agreements other than the Stock Purchase Agreement.

Matthew Smith Company makes much of the fact that the Arbitration Demand makes no mention of two promissory notes executed by Matthew Smith Company as part of the sale. It forgets, however, that both of these promissory notes were contained within the terms of the Stock Purchase Agreement. (CP 20) If that agreement is to be rescinded, than obviously those two promissory notes would also be rescinded.

d. Mr. Chill Was Prejudiced by Insufficient Notice.

Vacation of an arbitration award is proper when the arbitration was conducted without proper notice of initiation so as to

prejudice the rights of a party to the arbitration proceedings. RCW 7.04A.230(f). Matthew Smith Company suggests that Mr. Chill was not prejudiced by its failure to notify him by its intention to affect other agreements. That argument is baseless. If Matthew Smith Company had made its intentions clear before the arbitration hearing, Mr. Chill would have moved the court to stay arbitration under the terms of RCW 7.04A.070(2).

Matthew Smith Company then relies on RCW 7A.04.150(3) to contend that Mr. Chill should have made his motion prior to the hearing. Had he known of the intentions of Matthew Smith Company at that time, he would have. If a party has no idea what the other party intends, that party cannot be faulted for not taking action.

e. The Securities Act Would Not Have Allowed Cancellation of Other Agreements.

Matthew Smith Company argues that RCW 21.20 would have allowed the relief the arbitrators granted. That question cannot be a factor in determining the authority of the arbitrators. As *Boyd v. Davis* tells us, a court cannot determine substantive matters that the arbitrators have decided.

In any event, the Washington State Securities Act allows an aggrieved purchaser to recover “the consideration paid for the security.”

RCW 21.20.430(1). This relief can include the cancellation of an unpaid promissory note where the stock sale agreement refers to that note. *Kaas v. Privette*, 12 Wn.App. 142, 145, 529 P.2d 23 (1974). This rule would have allowed for the cancellation of the promissory notes referred to in the Stock Purchase Agreement.

The question presented, then, is precisely what was the consideration Matthew Smith Company gave for the stock? The Stock Purchase Agreement answers that question. It clearly states that Matthew Smith Company is purchasing the stock of \$4 million to be paid through a combination of cash and promissory notes. It makes no reference to the \$1 million promissory notes or any of the other agreements. Section 19.17 provides:

This Agreement contains the entire understanding of the parties regarding the subject matter of the Agreement and supersedes all prior and contemporaneous negotiations and agreements, whether written or oral, between the parties with respect to the subject of this Agreement.

(Emphasis added; CP 49) This language obviously allows for the possibility of other agreements between the parties. However, it contains all matters that relate to the sale of stock.

From this language, only one conclusion is possible — none of the other agreements formed any consideration for the purchase of

the stock. It is interesting to note that the arbitrators made no written finding to the contrary. (CP 8-10)

f. Matthew Smith Company Did Waive the Right to Arbitrate Other Agreements.

After Mr. Chill commenced suit on the \$1 million Promissory Note, the agreement concerning accounts receivable, and the Executive Employment Agreement, Matthew Smith Company did not move to stay arbitration. This amounted to a waiver of its rights to arbitrate as discussed at Brief of Appellant, pps. 24-5. Citing no authority directly to waiver of rights to arbitrate, Matthew Smith Company disputes this assertion in general terms. Its argument should be rejected.

g. Mr. Chill Could Not Move to Stay Arbitration When He Learned of the Intentions of Matthew Smith Company.

The arbitration demand submitted by Matthew Smith Company never addressed the other agreements. Incredibly, Matthew Smith Company argues that Mr. Chill should somehow divined its intention and then moved to stay arbitration. This argument is not in accord with the facts and makes no sense.

As previously indicated, Mr. Chill only learned of the intentions of Matthew Smith Company in this regard over one month after the arbitration hearing had been concluded. He then vigorously argued to the arbitrators that they had no power to affect other agreements. (CP 196)

It was only when the award was signed that Mr. Chill could that his arguments to the arbitrators were being rejected. If Matthew Smith Company had made its intentions prior to the hearing, Mr. Chill obviously would have addressed the matter to both the arbitration panel and to the Court.

Matthew Smith Company argues that it should not have had to gone through the expense of the arbitration only to learn later Mr. Chill believed that arbitrators had no power to affect the other agreements. Matthew Smith Company could have avoided this issue through simple forthrightness. For example, it could have sent another arbitration demand specifically addressing the other agreements or somehow otherwise made its intentions clear. Rather, it did the exact opposite. When Mr. Chill sued on other agreements, it answered, asserted counterclaims, and made no motion to stay the suit in favor of arbitration. It could also have avoided any issue by following Mr. Chill's suggestion and litigate all matters in court.

h. The Trial Court Improperly Determined Consideration for the Stock Sale as Part of Its Decision on the Scope of the Arbitrators Authority.

As pointed out in the Brief of Appellant, at pages 26-7, the trial court based its decision on vacation of the arbitration award on its finding as to consideration for the purchase of the stock. (CP 677)

Matthew Smith Company asserts that the trial court had no power to review the determinations made by the arbitrators. Mr. Chill agrees with that assertion of law.

The point here is not the correctness of the arbitrators' decision. Rather, the issue is whether the arbitration provision in the Stock Purchase Agreement gave them the power to affect other agreements. The trial court was required to determine that matter only on the basis of the language of the arbitration clause contained within the Stock Purchase Agreement in making that decision.

i. Conclusion.

The arguments made by Matthew Smith Company are meritless and should be rejected.

II. Assignments of Error Nos. 3-5.

Matthew Smith Company claims that Mr. Chill did not bring to the trial court's attention his objections to entry of judgment on less than all claims. This is simply not true. In Mr. Chill's response to Motion to Confirm Arbitration Award, he specifically argued that the Court should not enter a final judgment unless and until all claims between the parties were resolved. (CP 154-7)

The trial court prepared an order of its own findings in support of a judgment under CR 54(b). There was no opportunity to take exception to these findings. In any event, formal exceptions to court rulings are not necessary. CR 46. Furthermore, Washington has long subscribed to the rule that objections at the trial court level to Findings of Fact and Conclusions of Law are not necessary to preserve the right to contest those findings on appeal. *Larson v. Department of Labor & Industries*, 174 Wash. 618, 25 P.2d 1040 (1933); *Harmon v. Gould*, 1 Wn.2d 1, 94 P.2d 749 (1939), superseded by statute on other grounds as noted in *City of Olympia v. Palzer*, 107 Wn.2d 225, 728 P.2d 135 (1986); *Petroleum Nav. Co. v. King County*, 1 Wn.2d 489, 96 P.2d 467 (1939).

Finally, the Court was well aware of Mr. Chill's position as to Findings 1, 3, and 4. Mr. Chill had referred to the fact that the only arbitration agreement was contained in the Stock Purchase Agreement (Finding of Fact No. 1); that the trial court should not have confirmed the arbitration award (Finding of Fact No. 3); and that the arbitrators had overstepped their powers in affecting agreements between the parties containing no arbitration provision (Finding of Fact No. 4).

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III. Assignment of Error No. 6.

a. Introduction.

In the Brief of Appellant, pages 38-40, Mr. Chill argued that the any obligation to Matthew Smith Company was not a tort. Therefore, community property could not be reached to satisfy it. Matthew Smith Company disputes Mr. Chill's argument. However, its reasoning is flawed as will be shown below. It also incorrectly analyzes the due process rights of Abigail Chill and Jeffrey Rauth.

b. Matthew Smith Company Did Not Recover Tort Damages.

Relying on *Caplan v. Sullivan*, 37 Wn.App. 289, 679 P.2d 949 (1984), Matthew Smith Company distinguishes between "liabilities" on the one hand and "debts" on the other made in the opinion. It then goes on to urge the rule in *deElche v. Jacobsen*, 95 Wn.2d 237, 622 P.2d 835 (1980), applies to all "liabilities." That is not so, however. As *Caplan v. Sullivan*, *supra*, notes, "debts" are obligations arising from contracts or other voluntary obligations. By contrast, unliquidated obligations or those not arising from contract fall under the definition of "liabilities." Obligations under tort are included within the definition of "liabilities." However, other obligations are also "liabilities." These include obligations for child support, alimony, and taxes. 37 Wn.App. at 292. These obligations are obviously based on statute. For example, RCW

26.09.090 allows for maintenance while RCW 26.09.100 addresses child support. It should also be obvious that they are not obligations in tort. Therefore, the mere fact that the arbitration award was based on a statutory claim does not mean that it is a tort claim.

In *deElche v. Jacobsen, supra*, and subsequent cases, the Court allowed a plaintiff to levy against the tortfeasor's half of community property for torts not committed in the management of community property. The Court has not expanded the rule to obligations based on other "liabilities." Matthew Smith Company did not recover tort damages but received what is commonly referred to as rescissionary relief. (Brief of Appellant, pps. 38-40) Therefore, the rule set out in *deElche v. Jacobsen, supra*, and its progeny does not apply here.

Matthew Smith Company claims that Mr. Chill's argument is belied by the Court's decision in *Haley v. Highland*, 142 Wn.2d 135, 12 P.3d 119 (2000). That decision is not helpful here for two reasons. First of all, the plaintiff there did not make a rescission-based recovery. Secondly, the Court there did not consider the issue presented here.

In *Haley v. Highland, supra*, Mr. Haley lost \$122,350.00 based on the misconduct of Mr. Highland. His damages were set, however, at \$2,500.00 by both an arbitrator in a mandatory arbitration

proceeding and by the trial court on trial de novo. Under those facts, it is clear that he did not recover rescission based damages.

The issue presented here is whether damages based on rescission under RCW 21.20.430(1) are tort damages. This precise issue was not raised in *Haley v. Highland, supra*. It was not raised because the parties agreed that Mr. Haley had made a tort recovery. The Court of Appeals' decision in this matter sheds light on the parties' positions as follows:

Haley characterizes his claim as a statutory tort and relies on *deElche v. Jacobsen* to assert that he may reach Highland's share of the assets of the Highland marital community in order to collect this judgment. Highland agrees that the judgment arises from a tort but argues that because the tort was committed before Highland's marriage, Haley cannot recover from Highland's community property. Highland's argument relies on RCW 26.16.200 and *Caplan v. Sullivan*.

(emphasis added) *Haley v. Highland*, 92 Wn.App. 48, 50, 960 P.2d 962 (1998).

No court in *Haley v. Highland*, was ever asked to determine whether a claim under RCW 21.20 should be considered a tort. Therefore, *Haley v. Highland* is not authority for whether our case is a tort claim or not. Courts do not give precedential effect to cases that fail to specifically raise or decide an issue. *In re Registration of Electric Lightwave, Inc.*, 123

Wn.2d 530, 541, 869 P.2d 1045 (1994); *Berschauer/Phillips Construction Company v. Seattle School District*, 124 Wn.2d 816, 824, 881 P.2d 986 (1994); *Kucera v. Department of Transportation*, 140 Wn.2d 200, 220, 995 P.2d 63 (2000); *State v. Reinhart*, 77 Wn.App. 454, 458-59, 891 P.2d 735 (1995).

Matthew Smith Company relies on oblique dicta in decisions of the federal courts interpreting federal securities statutes—15 U.S.C. §§77, 78 to support its position. Those cases do not present or decide the issue raised here. Interestingly, dictum at odds with the position of Matthew Smith Company appears in an opinion deciding questions under RCW 21.20, *Helenius v. Chelius*, 131 Wn.App. 421, 448 *fn.* 36, 120 P.3d 954 (2005). The issue presented was whether post-sale conduct could yield to liability under RCW 21.20. The Court stated:

(Defendants) contend that it unwarranted and unnecessary to impose liability under WSSA for continuing deceptive conduct because a breach of contract or tort action would provide inadequate remedy. The WSSA is a remedial statute and its primary purpose is to protect investors from speculative or fraudulent schemes of promoters. . . (defendants) arguments fail to explain how this purpose is promoted if investors are required are also to pursue breach of contract or tort remedies for continuing deceptive conduct in connection with the sale of securities. . .

In other words, the Court recognized a distinction between a tort action on the one hand and an action based on RCW 21.20 on the other.

In any event, Washington courts are not bound by interpretations of federal securities statutes. This was made clear in *Kittilson v. Ford*, 93 Wn.2d 223, 608 P.2d 264 (1980). In that case, the Court held that proof of knowing deception is not necessary under RCW 21.20 despite a contrary holding from the United States Supreme interpreting federal securities laws.

As noted in the Brief of Appellant, tort damages are limited to those found to be caused by defendant's unlawful act. The Washington State Securities Act is based on the Uniform Securities Act. *Kittilson v. Ford, supra*. Causation is not an element of a private cause of action under the Uniform Securities Act. Official Comments to Uniform Securities Act 2002, Paragraph 4; *Ritch v. Robinson-Humphry Co.*, 748 So.2d 861 (Ala. 1999). Furthermore, the rescission remedy has nothing to do with actual damages caused by Matthew Smith Company due to whatever representations were made or withheld. Under RCW 21.20.430(1), Matthew Smith Company is entitled to recover the purchase price paid less certain statutory deductions.

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c. The Writs of Attachment Violated the Due Process Rights of Mrs. Chill and Mr. Rauth.

Matthew Smith Company concedes that neither Abigail Chill nor Jeffrey Rauth was given notice of the proceedings and an opportunity to be heard before Court allowed the writ of attachment. Nonetheless, Matthew Smith Company does not concede that Mrs. Chill and Mr. Rauth were denied due process. This argument ignores the nature of the due process interest that an owner of real property has.

In *Connecticut v. Doebr*, 501 U.S. 1, 111 S.Ct. 2105, 115 L.Ed.2d 1 (1991), the Court held that due process was offended by the failure to provide for notice and a hearing prior to levy of a writ of attachment. It based its decision upon the significant property interest that any property owner might have. As it stated:

We agree with the Court of Appeals that the property interests that attachment affects are significant. For a property owner like Doebr, attachment ordinarily clouds title; impairs the ability to sell or otherwise alienate the property; taints any credit rating; reduces the chance of obtaining a home equity loan or additional mortgage; and can even place an existing mortgage in technical default where there is an insecurity clause.

501 U.S. at 12. The State of Connecticut argued that a writ of attachment did not deprive the owner of use of the property. The Supreme Court responded that even temporary or partial impairments to property rights

that attachments entail are sufficient to merit due process protection. 501 U.S. at 11-12.

The writ of attachment impacts Mr. Rauth and Mrs. Chill in exactly the same way. It obviously clouds the title. It impairs their ability to sell the property and reduces the chances of obtaining a home equity loan. Matthew Smith Company obviously sought the writ of attachment to interfere with their property rights in just that way. In short, the levy of the writ interferes with the rights of Mrs. Chill and Mr. Rauth in connection with the property even if only Mr. Chill's undivided interest in the property can be the subject of the levy.¹

Contrary to arguments made by Matthew Smith Company, violation of due process stemming from the levy of a writ of attachment without prior notice and hearing may not be cured by a subsequent hearing. The Connecticut statute in *Connecticut v. Doebr, supra*, contained a provision allowing a property owner the right to seek a post-levy hearing. The Court held that this was not sufficient to cure the initial due process violation.

Matthew Smith Company also argues that Mrs. Chill and Mr. Rauth can make an adverse claim to the property under the terms of

¹ Counsel's research has not located decision in any court of the United States addressing this issue.

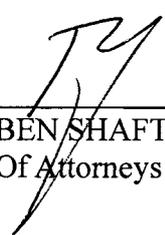
RCW 6.19.020. That statute is not applicable. It only applies when the adverse party has a claim to the property superior to that of the judgment debtor. *Simon v. Olympic Securities, Co.*, 130 Wash. 247, 226 P. 1019 (1924). That is obviously not the situation here.

In any case, Matthew Smith Company has it wrong. Due process requires notice and an opportunity to be heard before the writ is levied. That was the holding of *Connecticut v. Doehr, supra*. Since Mrs. Chill and Mr. Rauth were not afforded that right, the trial court should not have authorized the writs of attachment.

IV. Conclusion.

The arguments advanced by Matthew Smith Company are unavailing. The trial court erred as set out in the Brief of Appellant. Its decisions should be reversed.

DATED this 11 day of Sept, 2008.



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