

COURT OF APPEALS
DIVISION II
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STATE OF WASHINGTON
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No. 40171-1-II

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

HENRY DRAGT and JANE DRAGT, husband and wife,

Appellants,

v.

DRAGT/DETRAY, L.L.C., a Washington limited liability;
and E. PAUL DETRAY and PHYLLIS DETRAY,
and their marital community,

Respondents.

**APPELLANTS' OPENING BRIEF REGARDING FUNDS HELD IN
THE REGISTRY OF THE COURT**

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I. INTRODUCTION

This appeal concerns the priority of the parties' respective interests in approximately \$70,000 held in the registry of the Thurston County Superior Court. The funds are the proceeds from the sale of the Dragts' land and are subject to a security interest granted to the Dragts' attorneys. The Dragts claim that since they owned their land, they also own the proceeds from the sale of their land, and were therefore entitled to grant a security interest in those proceeds to secure continued representation in this lengthy litigation. The trial court, however, concluded that the Dragts lost their ownership rights in the funds once they were deposited with the court.

This appeal was originally assigned Appeal No. 41501-1-II. It relates to Appeal No. 40171-1-II, however, and arose after the parties had filed their respective briefs in the latter appeal. Accordingly, this Court consolidated this issue into Appeal No. 40171-1-II.

II. ASSIGNMENTS OF ERROR

1. The trial court erred in entering Conclusion of Law No. 1.
2. The trial court erred in entering Conclusion of Law No. 2.
3. The trial court erred in entering Conclusion of Law No. 3.

III. ISSUES PERTAINING TO ASSIGNMENTS OF ERROR

1. Did the trial court err in concluding that the Dragts had no ownership in or right to the funds held in the registry of the Thurston County court? [relating to Assignments of Error 1, 2 and 3]

2. Did the trial court err in concluding that the security interest granted by the Dragts did not attach to the funds held in the registry of the court? [relating to Assignments of Error 1, 2 and 3]

IV. STATEMENT OF THE CASE

The failed development.

In 1996, Henry and Jane Dragt (the “Dragts”) and Paul DeTray formed a limited liability company to develop land owned by the Dragts. The Dragts gave the company an option to purchase the land and DeTray contributed financing and expertise to develop the land. The Dragts intended to retire on the profits from their land.

The company was unable to develop the land, however. Frustrated after eight years of waiting, the Dragts sold their land to another developer, Tahoma Terra, LLC. This lawsuit ensued.¹

¹ These background facts are set out in this Court’s opinion in *Dragt v. Dragt/DeTray, LLC*, 139 Wn. App. 560, 161 P.3d 473 (2007), the first appeal in the litigation between these parties.

The lis pendens.

When the suit was commenced, DeTray filed a *lis pendens*, claiming an interest in title to the Dragts' land by virtue of the LLC's unexercised option. CP 676-78. At the time the *lis pendens* was filed, a payment of approximately \$70,704.93 was due from Tahoma Terra to the Dragts. CP 746-47. DeTray claimed that because he had an interest in the Dragts' land he was entitled to the proceeds from the sale of the land. CP 543-44. The Dragts maintained that DeTray had no interest in the land, that they owned their land free and clear of DeTray's alleged interest, and that they therefore owned the proceeds from the sale of their land. *Id.* Recognizing the issue could not be determined promptly, DeTray agreed to release his *lis pendens* if the Dragts deposited the sale proceeds into the registry of the court pending resolution of the parties' claims thereto. *Id.* The parties presented an agreed order to that effect, which order was entered by the court. *Id.* It is important to note that DeTray did not at any time seek a prejudgment writ against the funds. His claim to the funds arose exclusively out of his claim against title to the Dragts' land.

Trial and the first appeal.

The case proceeded to trial and the trial court determined DeTray owned the Dragts' land. The Court of Appeals reversed that decision,

firmly ruling that DeTray had no ownership interest in the Dragts' land.

Dragt v. Dragt/DeTray, LLC, 139 Wn. App. 560, 573-74.

Since the funds held in court were the proceeds from the sale of the Dragts' land, the funds were owned by the Dragts. Conversely, since DeTray had no ownership interest in the Dragts' land, he had no ownership interest in the sale proceeds.

Remand and the second appeal.

The Court of Appeals remanded the remainder of the case to the trial court to determine damages, if any, due to DeTray under quantum meruit. *Dragt v. Dragt/DeTray, LLC*, 139 Wn. App. at 564. The trial court entered another judgment. CP 754-55. That judgment is being reviewed by this Court.

Dragts' counsel.

Ryan, Swanson & Cleveland, PLLC ("RSC") has represented the Dragts since the inception of this litigation. CP 575. The Dragts signed an engagement letter in June 2004 committing to pay RSC for its legal services. CP 579-80.

When the Dragts sold their land to Tahoma Terra, LLC, they recognized they would likely get sued by DeTray. CP 573. Consequently, the Dragts negotiated an indemnification provision into their sales contract with Tahoma Terra, LLC, whereby Tahoma Terra agreed to reimburse the

Dragts for the legal fees incurred in litigation with DeTray. *Id.* Although the Dragts contracted with Tahoma Terra, the Dragts remained primarily liable to RSC for fees and costs incurred. CP 579-80.

For a period of time, Tahoma Terra paid the Dragts' legal expenses as agreed. CP 567-69. By the middle of 2009, however, Tahoma Terra was experiencing severe financial difficulties and stopped living up to its contractual obligations, including its duty to pay the Dragts' legal expenses. *Id.* As a result, the Dragts owe legal fees to RSC in an amount greater than the amount held in court. CP 575-77.

The security interest.

Due to the nature of the dispute and the severe adverse consequences to the Dragts, it was critical that the Dragts secure continued representation in Appeal No. 40171-1-II. CP 568. RSC, however, could not continue to represent the Dragts without being compensated. CP 576. Consequently, the Dragts agreed to pay RSC from the funds held in the registry of the court. CP 568, 576.

The Dragts executed a Security Agreement on April 29, 2010, and RSC's secured interest attached on that date. CP 617-21. RSC then perfected its security interest on May 20, 2010 by filing a UCC-1 Financing Statement with the Washington Secretary of State. CP 623-25.

Accordingly, as of May 20, 2010, RSC had a valid, perfected security interest in the funds held by the court.

The trial court's ruling.

The parties both moved for disbursal of the funds. CP 559. The trial court declined to decide the issue, then retired. CP 758-73. The Dragts moved again before another judge but the court denied the Dragts' motion and ordered the funds be disbursed to DeTray. CP 667-73, 785-88. DeTray did not have a lien, had not garnished or attached the funds nor done anything else to perfect an interest in those funds. CP 785-89. The trial court invited the Dragts to seek review in the Court of Appeals and stayed enforcement of its own order for 21 days so the Dragts could seek a stay. *Id.*

Appeal and consolidation.

The Dragts filed a notice of appeal on November 22, 2010. CP 790-91. They then moved for an emergency order staying enforcement of the trial court's November 19, 2010 order pending review, which motion was granted by this Court on December 9, 2010.

By order dated December 17, 2010, this Court consolidated this appeal into Appeal No. 40171-1-II.

Bankruptcy.

The Dragts ultimately ended up in a huge financial predicament. On one hand, the trial court entered a huge – and, in the Dragts’ view, excessive – judgment against them. CP 754-55, 576. On the other hand, the Dragts have not received the money they were supposed to have received from the sale of their land. Tahoma Terra still owes the Dragts more than \$1 million of the purchase price, and has failed to indemnify DeTray’s judgment and reimburse the Dragts’ legal fees as agreed in the purchase and sale agreement. CP 567-73. Tahoma Terra has lost the property to foreclosure, gone out of business and has no further assets to satisfy its obligations to the Dragts. *Id.* Consequently, if the trial court’s judgment is upheld, DeTray will receive all, and the Dragts none, of the proceeds from the sale of the Dragts’ land, a grossly unjust and inequitable result given that DeTray had no interest in the Dragts’ land and there was no breach of contract. *See Dragt v. Dragt/DeTray, LLC, supra.*

Although the Dragts committed to sell certain assets in an effort to satisfy the judgment, those efforts were unsatisfactory to DeTray. CP 787. Eventually, the Dragts had no choice but to file for bankruptcy protection.

V. ARGUMENT²

A. **The Dragts have an ownership interest in the funds held in the registry of the court; DeTray does not.**

The funds held in the registry of the trial court are the proceeds from the sale of Dragts' real property to Tahoma Terra, LLC. CP 543-45. The real property was owned by the Dragts at all pertinent times before they sold it to Tahoma Terra. *Dragt v. Dragt/DeTray, LLC*, 139 Wn. App. at 573-74. Since the Dragts owned the property, it follows that the Dragts also owned the proceeds from the sale of that property.

Conversely, DeTray has no interest in the funds held by the Court since his alleged interest was extinguished by the Court of Appeals. When this litigation commenced, DeTray filed a lis pendens against the Dragts' property, alleging he had an interest in title to the property the Dragts were selling to Tahoma Terra, LLC. CP 676-78. The Dragts disputed DeTray's claim to title but agreed to deposit the upcoming sale proceeds into the registry of the court pending determination of title. CP 543-45. Ultimately, the Court of Appeals determined that DeTray had no interest in the Dragts' real property. *Dragt v. Dragt/DeTray, LLC, supra*. Since

² All of the issues raised in this appeal are legal issues and are therefore reviewed *de novo*. *Skamania County v. Columbia River Gorge Comm'n.*, 144 Wn.2d 30, 42, 26 P.3d 241 (2001).

DeTray had no interest in the Dragts' real property, he had no interest in the proceeds from the sale of that property.

B. The Dragts granted RSC a security interest in the funds, which security interest is valid and perfected.

A debtor can grant a security interest in any collateral in which the debtor has an interest. RCW 62A.9A-109, 62A.9A-201 and RCW 62A.9A-203(b)(2). The manner in which one perfects a security interest is dictated by the type of collateral. Funds held in court constitute either an "account" or a "general intangible." RCW 62A.9A-102(2)(A) and (42). A security interest in such collateral attaches when the debtor signs a security agreement that contains a description of the collateral, value has been given and the debtor has rights in the collateral. RCW 62A.9A-203; *see also, Parker Roofing Co. v. Pacific First Federal Savings Bank*, 59 Wn. App. 151, 155, 796 P.2d 732 (1990). The security interest is perfected upon the filing of a financing statement. RCW 62A.9A-310.

Here, in order to secure continued representation in their protracted litigation with DeTray, the Dragts granted to their attorneys a security interest in the funds being held in the registry of the court. CP 568, 576. The Dragts executed a Security Agreement on April 29, 2010, and RSC's secured interest attached on that date. CP 617-21. RSC then perfected its security interest on May 20, 2010 by filing a UCC-1 Financing Statement

with the Washington Secretary of State. CP 623-25. Thus, as of May 20, 2010, RSC had a valid, perfected security interest in the funds held in the registry of the court.

C. RSC's secured interest in the funds has priority over any alleged interest DeTray may have in such funds.

RSC's perfected security interest has priority over and is superior to DeTray's subsequent interest. *Parker Roofing Co.*, 59 Wn. App. at 155. DeTray is merely a judgment creditor with no security interest in the funds. Although DeTray ultimately obtained a judgment against the Dragts (which judgment is on appeal), that judgment did not convey to DeTray any interest in the Dragts' personal property. In order to obtain an interest in the Dragts' personal property, DeTray had to obtain a writ of attachment or similar right, which DeTray did not do.

D. The trial court erred in failing to distribute the funds in accordance with the parties' respective interests therein.

Deposits of funds in court are governed by RCW 4.44.480 through 4.44.500 and CR 67. *Wilson v. Henkle*, 45 Wn. App. 162, 169, 724 P.2d 1069 (1986).

A court which has custody of funds has the authority and the duty to distribute the funds to the party or parties that show themselves entitled thereto, and this duty continues even after the entry of judgment or dismissal of the action in which the court gained custody of the funds.

Id. at 169, citing *Vallelunga v. Gomes*, 102 Cal.App.2d 374, 227 P.2d 550, 553 (1951).

In carrying out its duty, the court must protect and dispose of the funds “in accordance with the applicable principles of law and equity for the protection of the litigants and the public whose interests are affected by the final disposition thereof.” *Id.*, quoting *Market St. Ry. Co. v. Railroad Comm’n*, 28 Cal.2d 363, 171 P.2d 875, 878, cert denied, 329 U.S. 793, 67 S.Ct. 370, 91 L.Ed. 678 (1946).

The trial court below failed to dispose of the funds in accordance with applicable Washington law. It ignored the UCC, disregarded RSC’s perfected security interest in the funds, and failed to disburse the funds in accordance with the parties’ respective priority rights. Instead of distributing the funds to the party entitled thereto, the trial court tromped on the Dragts’ rights to their own property and eliminated their statutory rights under the UCC. *See, Wilson v. Henkle*, 45 Wn. App. 162, 170 (court-held funds were subject to attorneys’ lien and writ of attachment and priority between the competing interests was determined on a normal “first in time” basis). Just as in *Wilson*, the funds deposited with the Court

in this case are subject to RSC's lien³ and that lien has priority over DeTray's unsecured interest.

E. The trial court erred in concluding that the Dragts were divested of their interest in the funds when the funds were deposited into court.

The trial court concluded that the proceeds from the sale of the Dragts' land were held in *custodia legis* and that the Dragts were divested of their interest when those proceeds were deposited into court. CP 785-89. The trial court erred in both respects.

The sale proceeds at issue here were not held in *custodia legis*. Traditionally, only those funds that are the product of a writ of replevin or writ of attachment are held in *custodia legis*:

Doctrine of *custodia legis* provides that when personal property is repossessed under a writ of replevin, the property is considered to be in the custody of the court, though actual possession may be in either of the parties to the replevin action, and that property remains in the custody of the court until judgment in the replevin action finally determines whether the replevining party or the prior holder is entitled to possession.

Black's Law Dictionary, 5th ed. at 346 (1979). In Washington, the courts have extended the doctrine to apply to funds that are paid into court to satisfy a judgment, or when necessary to "prevent conflicts of jurisdiction with other courts." *Maybee v. Machart*, 110 Wn.2d 902, 906, 757 P.2d

³ RSC's lien is a UCC-9 lien rather than an attorneys' lien under RCW 60.40.010 but the treatment should be the same.

967 (1988), quoting *Hardy v. Construction Sys., Inc.*, 556 S.W.2d 843, 844 (Tex.Civ.App. 1977) (emphasis in original).

In this case, there was no writ of replevin or attachment, no conflict with another jurisdiction, and the funds were not deposited to satisfy a judgment. Rather, the sale proceeds were deposited while the parties litigated their competing claims to the Dragts' land arising out of DeTray's *lis pendens*. CP 543-45. No Washington court – or any other court for that matter – has ever ruled that funds deposited into court under these circumstances to be held in *custodia legis*.

DeTray relies on a First Circuit case, *Davis v. Cox*, 356 F.3d 76 (1st Cir. 2004) to argue a contrary position. But that opinion is consistent with Washington law. The court there held that under Maine law, when a court appoints a receiver to hold funds in escrow, those funds are held in *custodia legis* because escrow “operate[s], effectively, as an attachment of those funds.” Thus, just as with Washington law, Maine law holds that funds held under a writ of attachment are held in *custodia legis*.

There is a great distinction between funds that have been attached and those that have not. While title to an asset may pass when it is properly attached, title to the funds at issue here did not pass when they were deposited into court. The trial court failed to recognize this distinction.

The trial court erred further when it concluded that depositing the funds into court automatically divested the Dragts of their ownership interest therein. There was no writ of attachment, writ of garnishment or other legal mechanism that stripped the Dragts of their interest in the sale proceeds. Rather, the funds were deposited pending a determination of competing ownership claims thereto. CP 543-45. Once DeTray's claim to the Dragts' land was extinguished, the Dragts' ownership of the sale proceeds became unassailable.

Rather than divesting the Dragts of their ownership rights, the court was to honor those rights. Where funds are deposited in court absent a writ of garnishment, the parties with an interest in the funds are to "seek the court's determination of their priorities." And the court is to disburse the funds in accordance with applicable law, with the "first in time" rights prevailing over subsequent ones. *Wilson v. Henkle*, 45 Wn. App. at 170; *see also, State v. A.N.W. Seed Corp.*, 54 Wn. App. 729, 733, 776 P.2d 143 (1989) (writ of garnishment was "first in time" and therefore prevailed over the attorney's lien).

That is what the trial court should have done, but did not do, in this case. Since there was no writ of garnishment or attachment and ownership of the funds was resolved by the Court of Appeals, the trial court should have recognized the Dragts' superior right to the funds, honored the valid

security interest they granted therein, and disbursed the funds in accordance therewith. The trial court, however, did not disburse the funds in accordance with applicable law, and its failure to do so was error.

F. The trial court erred in concluding that the security interest granted by the Dragts did not attach to the funds.

The trial court also concluded that the security interest granted to RSC by the Dragts did not attach to the funds because the court “controlled” the funds. CP 787. This too was error. A debtor can grant a security interest in any collateral in which the debtor has an interest. RCW 62A.9A-109 and 62A.9A-201. The debtor’s right to pledge collateral is not affected by “control” of the collateral. Thus, the court’s control over the funds at issue did not defeat the Dragts’ right to grant a security interest therein.

VI. CONCLUSION

Based on the foregoing, the Dragts respectfully request that the Court reverse the trial court's November 19, 2010 order disbursing the funds held in the registry of the court to DeTray and award such funds to the Dragts.

DATED this 14th day of April, 2011.

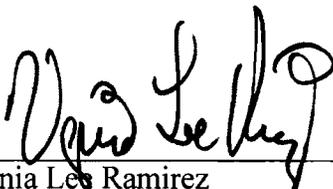
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DECLARATION OF SERVICE

I declare that on the 14th day of April, 2011, I caused to be served the foregoing document on counsel for respondents, as noted, at the following addresses:

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Virginia Lee Ramirez

Dated: April 14, 2011

Place: Seattle, WA

11 APR 15 PM 3:55
STATE OF WASHINGTON
BY _____
DEPUTY
Sergeant
C. J. [unclear]