

No. 40171-1-II

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

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HENRY DRAGT and JANE DRAGT, husband and wife,

Appellants,

v.

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

Respondents.

**BRIEF OF RESPONDENTS' REGARDING FUNDS HELD IN THE
REGISTRY OF THE COURT**

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I. STATEMENT OF THE CASE

The background facts of the underlying dispute between the Dragts and DeTrays are set forth in this court's opinion in *Dragt v. Dragt/DeTray, LLC*, 139 Wn.App. 560, 161 P.3d 473 (2007). In 2004, the Dragts entered into a contract to sell real property to Tahoma Terra, LLC, even though they had previously made agreements with the DeTrays to develop and sell the same in conjunction with them. *Dragt*, 139 Wn.App. at 565-568. The Dragts brought suit seeking a declaratory judgment that an option to purchase the real property they had granted to a limited liability company formed by the Dragts and DeTrays was void. *Id.* at 568. The DeTrays asserted several counterclaims, including: breach of fiduciary duties, breach of contract, unjust enrichment, and breach of an oral partnership. *Id.*

Before the sale to Tahoma Terra, LLC closed, The DeTrays filed a lis pendens against the Dragts' real property. CP 543-50. To effectuate closing of the sale to Tahoma Terra, LLC, on or about November 5, 2004, the Dragts and DeTrays entered into a Stipulation and Agreed Order Regarding Interpleader of Net Sale Proceeds. CP 543-545. The Dragts later deposited \$70,704.93 into the Superior Court registry pursuant to said Stipulation and Order. CP 746-47.

The DeTrays later secured a judgment against the Dragts for \$2,067,773.88 for breach of fiduciary duties and breach of contract. *Dragt*, 139 Wn.App. at 569. The Dragts appealed and this court affirmed in part, reversed in part and remanded the case back to the trial court. *Id.* at 578. After a hearing on remand, on December 15, 2009, the Superior Court granted judgment in favor of the DeTrays for \$1,745,704.35. The Dragts have also appealed that ruling to this court.

II. ARGUMENT

A. **The Standard for Review of the Trial Court's Decision to Release the Funds to DeTray is Abuse of Discretion.**

The issues of whether and to what extent the Dragts had rights in the funds deposited in the court registry and whether the Ryan, Swanson & Cleveland, PLLC law firm (hereinafter "RSC") held a perfected security interest in the funds are indeed questions of law which this court will review de novo. However, if this Court determines that the Dragts did not have rights in the funds at the time they attempted to grant RSC a security interest in the same, then the Superior Court's decision that the funds should be released to DeTray is reviewed for abuse of discretion. See, *Wilson v. Henkle*, 45 Wn.App. 162, 169, 724 P.2d 1069 (1986), citing, *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), *reh'g denied*, 329 U.S. 833, 67 S.Ct. 501, 91 L.Ed. 705 (1947).

B. RSC Does Not Have a Perfected Security Interest in the Funds on Deposit in the Court Registry Because the Dragts Did Not Have Rights in Those Funds When They Attempted to Grant a Secuity Interest to RSC.

The Superior Court has exclusive authority and control over funds that are on deposit with the court registry:

RULE 67. DEPOSIT IN COURT

In an action in which any part of the relief sought is a judgment for a sum of money or the disposition of a sum of money or the disposition of any other thing capable of delivery, a party, upon notice to every other party, and by leave of court, may deposit with the court all or any part of such sum or thing, whether or not that party claims all or any part of the sum or thing. The party making the deposit shall serve the order permitting deposit on the clerk of the court. Money paid into court under this rule shall be deposited and withdrawn in accordance with the provisions of RCW 4.44.480 through 4.44.500 or any like statute or rule.

CR 67 (1985). RCW 4.44.480 echoes the provisions of CR 67 and also makes it clear that once funds are deposited into the registry, only the court may decide to whom the funds should be distributed:

4.44.480. Deposits in court--Order

When it is admitted by the pleading or examination of a party, that the party possesses or has control of any money, or other thing capable of delivery, which being the subject of the litigation, is held by him or her as trustee for another party, or which belongs or is due to another party, the court may order the same to be deposited in court, or delivered to

such party, with or without security, subject to the further direction of the court.

RCW 4.44.480 (2003) (emphasis added). RCW 4.44.490 and 4.44.500 are inapplicable to the present controversy because the former outlines the court's ability to enforce a deposit order if it is disobeyed, and the latter merely states that funds on deposit in the court registry may not be loaned out.

After funds have been deposited into the court registry, the court has wide discretion to disburse them pursuant to applicable principles of law and equity, even after judgment has been rendered and the case dismissed:

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. Such a court

has the power and the responsibility of protecting the fund and of disposing of it 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. The court is said to be free, in the discharge of that duty and responsibility, to use broad discretion in the exercise of its powers so as to avoid an unlawful or unjust result.

Thus the court has wide discretion in the disposition of deposited funds.

Wilson v. Henkle, 45 Wn.App. 162, 169, 724 P.2d 1069 (1986) (citations omitted); See also, *Pacific Northwest Life Insurance Co. v. Turnbull*, 51 Wn.App. 692, 699, 754 P.2d 1262 (1988); *Maybee v. Machart*, 110 Wn.2d 902, 757 P.2d 967 (1988).

Here, RSC claims that it has a perfected security interest in the funds on deposit with the court. However, the RSC security interest did not attach to the funds held in the court registry because the debtors (Dragts) did not have any rights in the collateral, nor did they have the power to transfer rights in the same. In order to determine whether a security interest attaches to particular collateral, the following statute controls:

62A.9A-203. Attachment and enforceability of a security interest; proceeds; supporting obligations; formal requisites

(a) **Attachment.** A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(b) **Enforceability.** Except as otherwise provided in subsections (c) through (i) of this section, a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(1) Value has been given;

(2) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(3) One of the following conditions is met:

(A) The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned; ...

RCW 62A.9A-203 (a) and (b) (2000) (emphasis added). Here, RSC may have given value and the Dragts may have authenticated a security agreement that provides a description of the collateral, but the Dragts did not have rights in the collateral, and therefore RSC's security interest did not attach.

In *Wilson v. Henkle*, 45 Wn.App. 162, 724 P.2d 1069 (1986), Henkle purchased a home previously owned by Wilson at a trustee's sale. *Henkle*, 45 Wn.App. at 164. After all liens were paid, a surplus from the sale remained on deposit in the registry of court. *Id.* Wilson then sued Henkle to set aside the sale and Henkle brought an unlawful detainer action against Wilson. *Id.* The cases were consolidated and the surplus funds were transferred to the new cause number. *Id.* The court ruled in favor of Henkle, entered a judgment against Wilson, and subsequently ordered the funds held in the registry of court to be paid to Henkle in satisfaction of their judgment. *Id.* at 164-65.

Henkle is analogous to the present case in that proceeds from the sale of real property were deposited into the registry of court. Significantly, in the present matter, the funds were deposited pursuant to a stipulation of the parties because both parties made claims to ownership of the funds. CP 543-545. In *Henkle*, the Henkles never asserted ownership over the funds. In fact, the funds were the surplus of monies the Henkles themselves paid to the trustee to purchase the real property. Nonetheless, the court exercised its discretion and allowed the funds to be distributed to Henkle in partial satisfaction of their judgment against Wilson.

The Dragts argue that the doctrine of *custodia legis* only applies to (1) funds that are received as the result of writs of replevin or attachment, (2) funds that are paid to satisfy a judgment, or (3) situations where it is necessary to prevent jurisdictional conflicts with other courts. Appellants' Opening Brief at 12. The Dragts cite the Black's Law Dictionary, 5th Edition, as authority for the premise that *custodia legis* only applies to funds repossessed under a writ of replevin. *Id.* First, the Dragts cite no Washington authority that has adopted that section of the Black's Law Dictionary, 5th Edition, and therefore it does not define Washington law on the topic. Second, the Dragts cite no other Washington

authority holding that *custodia legis* is as narrowly defined in this state as they claim.

The Dragts then go on to cite the dissenting opinion in *Maybee v. Machart*, 110 Wn.2d 902, 757 P.2d 967 (1988) for their conclusion that this state limits the application of *custodia legis* to particular situations. Appellants Opening Brief at 12-13. A fair reading of *Maybee* shows that there is no such limitation. In *Maybee*, judgment debtors of Machart and Bales voluntarily deposited funds to satisfy the judgments against them into the registry of court. *Maybee*, 110 Wn.2d at 903. The judgment debtors were not required by court order, stipulated or otherwise, to deposit the funds into the court registry. *Id.* Thereafter, a judgment creditor of Machart and Bales attempted to garnish the funds, and at least two other creditors of Machart and Bales claimed liens on the funds. *Id.* at 903-04. The trial court entered a judgment in favor of the garnishing judgment creditor, but the Supreme Court reversed stating:

The fundamental premise of our holding is that the clerk held the funds in question in *custodia legis*. The general rule is that property which is in *custodia legis* is not subject to garnishment.

The purpose of the *custodia legis* principle is to preserve the jurisdiction of the court which has possession of the funds.

When the purpose of the custody of the law has been accomplished and a party has become entitled to payment or possession without further action by the court, those funds are subject to garnishment. Thus, where the court has directed by order that the funds be paid to a particular litigant, they are properly subject to garnishment.

Maybee v. Machart, 110 Wn.2d 902, 904-05, 757 P.2d 967 (1988) (citations omitted). If the funds deposited in *Maybee* were held in *custodia legis*, then certainly the funds deposited in the present case were as well. Here the funds were deposited pursuant to a stipulated motion and order, which motion recognized “[The DeTrays assert] claims against those sale proceeds and [the Dragts] dispute those claims.” CP 543. The stipulation and order further provided that the funds “shall not be released or disbursed without further order of this court.” CP 545. If the funds in the *Maybee* case were held in *custodia legis* when judgment debtors deposited them into the court registry without a stipulation and court order, then certainly the funds here were held in *custodia legis* when the parties agreed that ownership of the funds was disputed and that the funds could only be distributed upon a further order of the court.

Since the funds were held in *custodia legis*, the Dragts could not grant a security interest in them and the DeTrays could not

obtain the funds by garnishment or attachment. The only way to properly obtain the funds was to make a motion to the Superior Court and have it determine the party to whom to release the funds. The DeTrays made such a motion and the Superior Court ruled that the funds should be released to them in partial satisfaction of their judgment.

C. Other Jurisdictions Have Held that Funds on Deposit With the Registry of Court are Held In *Custodia Legis*.

When a court orders funds to be deposited into the registry of court pending further order of the court, it divests the parties of legal title and title to the funds passes to the clerk as trustee. *Davis v. Cox*, 356 F.3d 76 (1st Cir. 2004). In *Davis*, a state court ordered the parties to deliver certain monies to their attorneys to be held in trust pending further order of the court. *Davis*, 356 F.3d at 79. Later, it was determined that the funds could not be considered as part of one of the parties' bankruptcy estate because that party did not hold title to the funds while they were on deposit, even though that party may have had a contingent or remainder interest in the funds:

When the state court directed the attorneys to place the money in escrow accounts and to disburse the money only upon an order of the court, the funds were placed in custodia legis and Cox was divested of legal title of the funds and title

passed to the attorneys as officers of the court. As a result, the funds held in custodia legis did not pass into the bankruptcy estate upon the filing of the bankruptcy petition. As noted by the bankruptcy court, at the commencement of the bankruptcy proceeding, Cox held just a contingent interest to the property held in custodia legis, subject to the divorce court's disposition of the property.

Id. at 93-94 (emphasis added). Here, once the Dragts paid the funds into the registry pursuant to the order of this court, they were divested of legal title and they merely had a contingent interest in the funds. A contingent interest does not rise to the level of "rights in the collateral," nor does it entitle the interest holder to transfer rights to the same to a secured party. It is for this same reason that the DeTrays, as judgment creditors, were not able to attach or garnish the funds because the Dragts had no legal interest in them:

It is, of course, well settled that deposits in court, like any other property *in custodia legis*, are not, as a matter of course, subject to attachment, garnishment, levy of execution, lien of creditors' bill or other process, whether issuing out of another court or the very court in which the same are deposited.

Bank of Hawaii v. Benchwick, 249 F.Supp. 74, 79 (1966) (emphasis in original); see also, *Arizona Land Corporation v. Sterling*, 5 Ariz.App. 4, 8, 422 P.2d 734 (1967); *Davis*, 356 F.3d at fn. 16. So long as the funds are held by the court, neither Dragt nor DeTray

holds title to the funds, and therefore, a security interest could not attach.

A similar holding is set forth in the case of *In re Anthony Sicari, Inc.*, 151 B.R. 60 (S.D.N.Y. 1993). In *Sicari*, the court held that funds from the sale of real estate, which were deposited into the registry of court pursuant to state court litigation, were not part of the bankruptcy estate of one of the parties to the state court action. *Sicari* 151 B.R. at 62.

D. The Trial Court Appropriately Exercised Its Discretion in Distributing the Funds to the DeTrays.

After the Superior Court correctly held that RSC did not have a valid security interest in the funds held in the registry of court, it exercised its authority as recognized in *Henkle* and distributed the funds to the DeTrays. As between RSC and the DeTrays, the Superior Court decided that the DeTrays, as the judgment creditor of the Dragts in the very same action in which the funds were deposited into the court registry, were the parties entitled to the proceeds. The Dragts have made no argument as to how the Superior Court may have abused its discretion in making this ruling. Therefore, if this court determines that RSC had no security interest

in the funds on deposit, it must follow that the Superior Court did not abuse its discretion and the decision should be affirmed.

E. The Dragts' Financial Health and Their Appeal of the Underlying Judgment Have No Bearing on this Appeal.

In their opening brief, the Dragts stated that they are in a "huge financial predicament" in that they owe the judgment to the DeTrays while Tahoma Terra, LLC still owes them over one million dollars and has failed to indemnify the Dragts for legal fees. Appellants' Opening Brief at 7. The Dragts alleged financial predicament has no bearing whatsoever on this appeal and should not be a factor in this court's decision. The Dragts were unjustly enriched when they sold the real property to Tahoma Terra, LLC and cut the DeTrays out of the deal. If they did not receive all of the sale proceeds from Tahoma Terra, that is a consequence of the deal they made and that has no bearing on the issues presented here.

Also, the fact that the Dragts have appealed the trial court's second judgment in favor of the DeTrays does not affect the issue on review here. The Dragts have not filed a supersedeas bond or cash, and therefore, the DeTrays may seek enforcement of the judgment while review is pending. RAP 8.1(b) (2006).

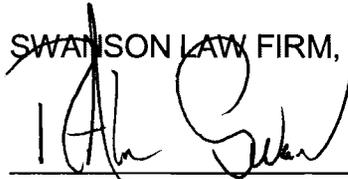
III. CONCLUSION

The DeTrays respectfully request that this court affirm the ruling of the Superior Court distributing the funds held in the registry of the court to them.

DATED this 10 day of May, 2011.

Respectfully submitted,

SWANSON LAW FIRM, PLLC

Handwritten signature of R. Alan Swanson and Trevor A. Zandell, written in black ink over a horizontal line.

R. Alan Swanson, WSBA #1181
Trevor A. Zandell, WSBA #37210
Of Attorneys for Respondents

DECLARATION OF SERVICE

On the 10th day of May, 2011, I caused to be served the foregoing document on counsel for Appellants, at the following address:

Kevin A. Bay, Esq.
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Seattle, WA 98101

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.


Sarah A. Smith

Dated: May 10th, 2011

Place: Olympia, WA

