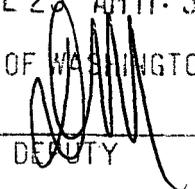


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DIVISION II

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STATE OF WASHINGTON

BY  _____
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No. 47292-9-II

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

JOHN J. HAUGHNEY,

Appellant,

v.

MERIDIAN PLACE, LLC,

Respondent.

BRIEF OF APPELLANT

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ORIGINAL

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I. INTRODUCTION

This lawsuit arises from the lease and subsequent sale of a fitness center in Puyallup, Washington. Respondent/Plaintiff Meridian Place, LLC (“Meridian”) alleges that Appellant/Defendant John J. Haughney (“Haughney”), a shareholder of Humcor, Inc. (“Humcor”), orchestrated a fraudulent transfer of Humcor’s assets located at Meridian’s leased premises. Although the Court of Appeals has previously ruled on Haughney’s liability associated with the sale, the present appeal concerns only the dollar amount of Meridian’s damages. Simply put, Meridian contends its damages amount is \$560,736.46, and Haughney contends the amount is \$353,293.96. The trial court ruled in Meridian’s favor. However, the trial court erred in computing Meridian’s damages because it did not subtract the entire amount of a senior secured claim held by Cascade Bank against the collateral sold. The Court of Appeals should vacate the trial court’s judgment and instruct the trial court to enter judgment against Haughney in the reduced amount of \$353,293.96.

II. ASSIGNMENTS OF ERROR

A. Error 1: Finding of Fact No. 2.¹ The trial court erred in finding that the assets were transferred to James Loveall free and clear of Cascade

¹ Pursuant to RAP 10.4(c), the full text of the Supplemental and Amended Findings of Fact and Conclusion of Law, including those Haughney is assigning error to, is contained in Appendix A.

Bank's perfected security interest.

B. Error 2: Finding of Fact No. 2.² The trial court erred in finding that Cascade Bank's perfected security interest did not diminish the value of the equipment transferred to James Loveall.

C. Error 3: Conclusion of Law No. 1.³ The trial court erred in not deducting the entire amount of Cascade Bank's secured claim in determining the amount of Meridian's damages.

III. ISSUES PERTAINING TO ASSIGNMENT OF ERRORS

A. Should the trial court's amended judgment be reversed and vacated because the trial court incorrectly computed Meridian's damages? (Errors A through C)

IV. STATEMENT OF THE CASE

A. Factual Background.

1. Humcor's Fitness Business.

Humcor, a Washington corporation, operated two fitness centers and was doing business under the name of "Callaway Fitness." CP 201. One of the fitness centers was located at 17615 85th Avenue Court East, Suite A, Puyallup, WA 98375 ("Callaway I"), and the premises were

² Pursuant to RAP 10.4(c), the full text of the Supplemental and Amended Findings of Fact and Conclusion of Law, including those Haughney is assigning error to, is contained in Appendix A.

³ Pursuant to RAP 10.4(c), the full text of the Supplemental and Amended Findings of Fact and Conclusion of Law, including those Haughney is assigning error to, is contained in Appendix A.

leased by Humcor from a landlord other than Meridian. CP 297. The second fitness center was located at the Meridian Place Shopping Center in Puyallup, WA (“Callaway II”), and the premises were leased by Humcor from Meridian pursuant to a lease agreement dated June 7, 2006. CP 4. On or about June 22, 2006, Humcor entered into a first amendment to the lease agreement with Meridian. CP 4. Pursuant to the first lease amendment, Humcor granted Meridian a security interest in “all goods (including, without limitation, equipment and inventory), fixtures, and other personal property of Tenant [Humcor] situated on the Premises from time to time, and all proceeds thereof.” CP 4. Meridian never had a security interest as to personal property located at the Callaway I premises. CP 314-16. On or about January 26, 2007, Humcor entered into a second amendment to the Meridian lease. CP 4. Pursuant to the second amendment, the lease term was established as between February 1, 2007, through January 31, 2012. CP 4-5.

Haughney was a shareholder of Humcor and owned a 42% interest. CP 201.

2. Sale of Callaway I.

In an attempt to resolve Humcor’s financial difficulties with Callaway II, on or about April 1, 2008, Humcor entered into a purchase and sale agreement (“Agreement”) with James D. Loveall whereby

Humcor sold to Loveall all of the assets of Callaway I. Trial Ex. 1. The purchase price set forth in the Agreement was \$750,000. Trial Ex. 1, at p. 2. Loveall agreed to assume certain debt in the amount of \$635,736.46, and pay \$114,263.54 in cash. Trial Ex. 1, at p. 2.

3. Cascade Bank Loan.

On or about January 25, 2008, Humcor borrowed \$325,000 from Cascade Bank to refinance and pay off leases and other debts. CP 310. Also on January 25, 2008, Humcor entered into a Security Agreement with the Bank in which Humcor gave a security interest in favor of the Bank regarding the following collateral: accounts and other rights to payment, general intangibles, and equipment. CP 310. Cascade Bank also filed a UCC-1 financing statement on January 31, 2008, regarding this collateral. CP 310. Cascade Bank's perfected security interest was in first position with respect to the assets of Callaway I.⁴ CP 310-11. Cascade Bank also had a first-position secured claim as to the assets of Callaway II. CP 156-57.

As of March 31, 2008, the day before Humcor closed on its sale of Callaway I's assets to Loveall, the balance of Cascade Bank's loan to

⁴ The Callaway I assets were also subject to the secured claim of Smart Lending, LLC ("Smart Lending"), whose security interest was unperfected as of the date of the Callaway I asset sale closing. CP 310-14. Whether the Smart Lending secured claim should have been deducted in computing Meridian's damages is not an issue raised in this appeal by Haughney.

Humcor was \$321,706.04. CP 310; Trial Ex. 5A. Cascade Bank did not release its security interest in the Callaway I assets until 23 days later, on April 24, 2008. CP 233, 314; Trial Ex. No. 1.

B. Procedural History.

1. Meridian's Lawsuit and Initial Rulings by Trial Court and Appeals Court.

On July 8, 2010, Meridian filed its second amended complaint in Pierce County Superior Court, Case No. 08-2-08784-6, against Humcor and other parties alleging breach of lease and foreclosure of landlord's lien and security interest. CP 8-11. The second amended complaint also contains fraudulent transfer claims against Loveall and Smart Lending, as well as a veil piercing claim against Haughney, regarding the sale of Callaway I. CP 11-12. The second amended complaint also includes fraudulent transferee claims against Michael Petrovic, who had subsequently acquired the Callaway I assets from Loveall. CP 13.

The case went to trial, which took place in May 2011. CP 364. On June 9, 2011, Judge Hickman issued an oral ruling and read his findings of fact and conclusions of law into the record. CP 198-216. On June 30, 2011, the court entered judgment against Haughney in the amount of \$75,000, representing the value of Callaway I. CP 186-87, 407. Haughney immediately paid the \$75,000 judgment. CP 364-68.

Meridian then appealed the state court ruling, in part based on the trial court's judgment amount of \$75,000 against Haughney. CP 159. On August 20, 2013, the Washington State Court of Appeals issue its written ruling in which it held that the trial court erred in determining the amount of Meridian's damages. CP 165. The appeals court vacated the amount of the trial court's damages award to Meridian and remanded for a hearing on recalculation of the damages amount "based on RCW 19.40.081 and the relevant evidence." CP 166.

On remand, Judge Hickman from the Pierce County court issued an oral ruling on December 20, 2013, adjusting its damages award to \$350,000, consisting of a \$750,000 value assigned to Callaway I, less Cascade Bank's security interest in the amount of \$325,000, less the \$75,000 payment already made by Haughney on the original judgment. RP (12/20/13) 44-48. Meridian sought reconsideration of the December 20, 2013, ruling. CP 295-301. However, before the hearing on Meridian's reconsideration motion took place, Haughney filed for Chapter 7 bankruptcy. CP 309.

2. Subsequent Decisions by Bankruptcy Court and Trial Court.

Meridian filed a nondischargeability complaint in bankruptcy court alleging that alleged debt of Haughney to Meridian in the amount of

\$675,000 is nondischargeable pursuant to Sections 523(a)(2)(A) and 523(a)(6) of the Bankruptcy Code. CP 309. On August 8, 2014, Haughney filed a motion for partial summary judgment on the issue of damages with respect to the Section 523(a)(2)(A) claim. CP 309, 327. At the September 5, 2014, hearing on that motion, the bankruptcy court *sua sponte* granted relief from stay to permit the Pierce County Superior Court to rule on the amount of damages, if any, incurred by Meridian. CP 309, 327.

On January 9, 2015, the Pierce County court issued a memorandum decision on the issue of damages, ruling that the damages amount is \$560,000. CP 364-68. On February 6, 2015, the Pierce County court entered supplemental and amended findings of fact and conclusions of law, as well as an amended judgment against Haughney. CP 396-99. On March 5, 2015, Haughney filed and served a notice of appeal of the amended judgment. CP 403-17.

V. ARGUMENT

A. Standard of Review.

An appellate court reviews a trial court's findings of fact under the substantial evidence test. *Guarino v. Interactive Objects, Inc.*, 122 Wn. App. 95, 108, 86 P.3d 1175 (2004). If the factual findings are supported by substantial evidence, those findings are used to determine whether they

support the trial court's conclusions of law. *Id.* The trial court's determinations on questions of law are reviewed *de novo*. *Rasmussen v. Bendotti*, 107 Wn. App. 947, 954, 29 P.3d 56 (2001). The legal conclusion to be drawn from the facts is a mixed question of law and fact that is reviewed *de novo*. *Clayton v. Wilson*, 168 Wn.2d 57, 62, 227 P.3d 278 (2010).

B. The Full Amount of Cascade Bank's Secured Claim Should Have Been Deducted in Computing Meridian's Damages.

Under the fraudulent transfer statute, “the creditor may recover judgment for the value of the asset transferred, as adjusted under subsection (c) of this section, or the amount necessary to satisfy the creditor's claim, whichever is less.” RCW 19.40.081(b). “If the judgment under subsection (b) of this section is based upon the value of the asset transferred, the judgment must be for an amount equal to the value of the asset at the time of the transfer, subject to adjustment as the equities may require.” RCW 19.40.081(c). The definition of “asset” explicitly excludes “[p]roperty to the extent it is encumbered by a valid lien.” RCW 19.40.011(2)(i). “Valid lien” is defined as “a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.” RCW 19.40.011(13). “Lien” is defined as “a charge against or an interest in property to secure payment of a debt or

performance of an obligation, and includes a security interest created by agreement, a judicial lien obtained by legal or equitable process or proceedings, a common-law lien, or a statutory lien.” RCW 19.40.011(8). “Foreclosure, or sale of an asset for no net profit, means the asset was fully encumbered and therefore not an ‘asset’ for purpose of the UFTA.” *Thompson v. Hanson*, 142 Wn. App. 53, 66, 174 P.3d 120 (2007).

Cascade Bank’s perfected security interest should be taken into account at the full \$325,000 claim amount in determining the amount of alleged damages incurred by Meridian. There is no dispute that the Bank had a claim of \$325,000 secured by the assets of both Callaway I and Callaway II. Assuming that the value of Callaway I’s assets was \$750,000, as of April 1, 2008 (the date of sale closing), Cascade Bank still had a secured claim against the Callaway I assets in the amount of \$325,000 and could look to that collateral for satisfaction of its entire \$325,000 claim. Cascade Bank’s claim as to the Callaway I collateral as of April 1, 2008, was not limited simply because it also had recourse to the Callaway II collateral. Although the Bank’s claim was partially paid down, more than three (3) weeks later, with cash consideration provided by Loveall, that does not change the fact that as of the transfer date, Cascade Bank had a secured claim of \$325,000 against the Callaway I assets.

Furthermore, in the first appeal, the appeals court stated that “the trial court properly considered Cascade Bank’s lien in adjusting the damages award downward because UFTA does not treat encumbered property as an ‘[a]sset’ of the fraudulent transferor.” CP 164. The appeals court also stated that a \$325,000 downward adjustment, based on the rough amount of Cascade Bank’s entire secured claim, was “statutorily authorized.” CP 164. Therefore, the full \$321,706.04 should be deducted in computing Meridian’s damages.

C. Cascade Bank’s Lien Release Was a Separate Transaction that Occurred Weeks After the Sale Closed.

Cascade Bank’s lien release was not part of this single asset purchase transaction. The lien release occurred weeks after the sale closed, was not a condition to closing the sale, and is not even mentioned in the purchase and sale agreement, which has its own integration clause. Trial Ex. No. 1, at p. 8 (para. 7.7).

According to the Agreement, the closing date of the sale was April 1, 2008, provided that all conditions to sale closing set forth in the Agreement were satisfied. Trial Ex. No. 1, at p. 3 (para. 3.1). One such condition was Loveall’s delivery to Humcor of a check in the amount of \$114,263.54 payable to Humcor. Trial Ex. No. 1, at p. 3 (para. 3.6). On April 1, 2008, Loveall delivered, and Humcor, received, a check dated

April 1, 2008, in the amount of \$114,263.54 payable to Humcor. CP 397; Trial Ex. No. 1. Cascade Bank did not release its security interest in the Callaway I assets until 23 days later, on April 24, 2008. CP 233, 314; Trial Ex. No. 1. Because all conditions to sale closing occurred on or before April 1, 2008, the sale closed on April 1, 2008, and Cascade Bank's perfected security interest was still in place at the time of the sale closing. CP 314. Humcor did not deposit the check from Loveall into its bank account until April 22, 2008, out of concern that an intervening judgment creditor could garnish Humcor's bank account. CP 314. Payment to Cascade Bank for release of its security interest was not a condition of sale closing and is thus irrelevant in determining the date of sale closing. CP 314.

Furthermore, Cascade Bank was not a party to the Purchase and Sale Agreement, and Humcor and Loveall could not unilaterally eliminate Cascade Bank's security interest through sale of the assets without the Bank's consent. The Bank's security interest would simply follow the collateral wherever it was transferred to. And just because the Purchase and Sale Agreement states that the assets will be sold "free and clear" of liens does not mean that the liens cease to exist. It merely means that the sale proceeds will be used to clear the liens. Section 9-315 of

Washington's version of the Uniform Commercial Code set forth both of these principles:

(a) Disposition of collateral: Continuation of security interest or agricultural lien; proceeds. Except as otherwise provided in this Article and in RCW 62A.2-403(2):

(1) A security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(2) A security interest attaches to any identifiable proceeds of collateral.

RCW 62A.9A-315(a).

Cascade Bank did not authorize the security interest release until April 24, 2008, more than three (3) weeks after the sale closed. Therefore, the Bank's security interest remained in place at the time of the transfer, which occurred on April 1, 2008.

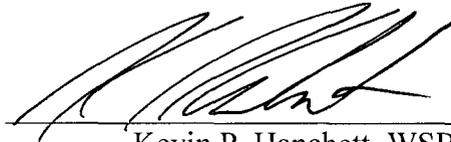
VI. CONCLUSION

There was no basis for the trial court to enter judgment in favor of Meridian in the amount of \$560,736.46. The trial court erred by deducting only a portion of Cascade Bank's secured claim in determining Meridian's damages. The entire secured claim of \$321,706.04 should have been deducted. Therefore, the Court of Appeals should vacate the amended judgment and instruct the trial court to enter judgment against Haughney in the amount of \$353,293.96.

Therefore, appellant John J. Haughney respectfully requests that the Court:

1. Reverse the trial court's award of damages in favor of Meridian in the amount of \$560,736.46;
2. Vacate the trial court's amended judgment entered in favor of Meridian in the amount of \$560,736.46; and
3. Remand the case to the trial court with instructions to enter an amended judgment in favor of Meridian in the amount of \$353,293.96.

Respectfully submitted this 23rd day of July, 2015.



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CERTIFICATE OF SERVICE

I certify that on July 23, 2015, I caused a copy of the foregoing document to be served via legal messenger to the following counsel of record:

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