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

JOHN J. HAUGHNEY,

Appellant,

v.

MERIDIAN PLACE, LLC,

Respondent.

REPLY BRIEF OF APPELLANT

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STATE OF WASHINGTON
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ORIGINAL

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I. INTRODUCTION

Meridian Place, LLC's responsive brief misapplies the equitable considerations under RCW 19.40.081(c). There is nothing in RCW 19.40.081(c) that allows the trial court to disregard a valid lien on property transferred. The trial court does not have the discretion to step outside of the statutory requirement that in determining the value of an asset transferred a valid lien must be excluded from the value of the asset. *See* RCW 19.40.011(2)(i). However, this is exactly what the trial court did, and this court must vacate the Judgment and remand to the trial court with instructions to enter a judgment in the net amount of $353,293.96.

The facts are largely not in dispute. Callaway I's assets were worth $750,000 at the time of the transfer. At the time of the transfer, the assets were encumbered by a "valid lien" in the amount of $325,000. Twenty one days after the transfer, the Cascade Bank released its lien on Callaway I's assets for a payment of $117,500. There has been no ruling that the lien in the amount of $325,000 was somehow "invalid" or had been released at the time of the transfer. Therefore, under RCW 19.40.011(2)(i), on the date of the transfer the value of the assets transferred was $425,000. There is no statutory authority for the Court to value the assets transferred at any amount other than $425,000. By disregarding the valid lien, the trial court acted outside its statutory authority and abused its discretion.

The economic reality is that Meridian is seeking a windfall by asking the Court to value the assets at $635,736.46. The trial court found that the $325,000 lien was a "valid lien", because the lien was effective against a judicial lien holder, i.e., Meridian, at the time of transfer. By trying to get credit for a lien release completed after the transfer, Meridian seeks a benefit that was not available to it. Had Meridian executed upon the assets on the day of transfer, the assets would have remained subject to Cascade Bank's $325,000 lien. Meridian would have been required to satisfy that $325,000 lien to realize any value in a subsequent Sheriff's Sale of the property.

Meridian asks this Court to award damages based upon a hypothetical lien release which was not available to Meridian. There is no evidence before the Court that Meridian had a deal with Cascade Bank to release its lien for $117,500, or any amount other than the full payment of the secured debt, had Meridian seized Callaway I's assets. The value of the valid lien is determined by the amount of the lien that could be enforced against Meridian at the time of the transfer, because that is the only way to determine the "actual" damage to Meridian from the transfer.

The UFTA is intended to compensate the aggrieved party for the value they could have realized, but for the transfer of the assets. The UFTA was not intended to give the creditor a windfall when a lien release it could not have benefited from is granted after the transfer. The trial court and Meridian are not entitled to speculate that Meridian would

have been able to obtain a lien release similar to the one obtained by James Loveall.[1] The finding by the trial court that Cascade Bank's $325,000 lien was a "valid lien" pursuant to RCW 19.40.011(13), *See* CP 366, is determinative of the value of the assets under RCW 19.40.011(2)(i). The value of the assets transferred was $425,000. The subsequent release of lien by Cascade Bank does not change the value of the valid lien at the time of the transfer. In this case, the Court committed an error of law in determining the value of the assets transferred was $635736.46 minus the $75,000 payment already made to Meridian. The judgment must be reversed, and the Court directed to enter a judgment for the value of the assets transferred of $425,000 with credit for the $75,000 already paid for a net judgment of $353,293.96.

II. ARGUMENT

A. The Value Of The Assets Is Determined At The Time Of Transfer.

The plain language of the statute is that only the equity in "excess" of the valid lien is an "asset" under the UFTA. *Oregon Account Systems, Inc. v. Greer*, 165 Or. App. 738, 743-44, 996 P.2d 1025 (2000). The value of the valid lien is determined by the value of the lien as of the date of transfer. *National Loan Investors, L.P. v. World Properties, LLC*, 79 Conn. App. 725, 732-33, 830 A.2d 1178 (2003). "A security interest that is compromised prior to transfer of the secured property will be

[1] Meridian's motion refers to Mr. Loveall as "John Loveall", his name is actually "James" or "Jim" Loveall. CP 156, 364, 397.

included in a determination of the property's security status at the compromised value." *In re Expert S. Tulsa, LLC*, 534 B.R. 400, 411 (B.A.P. 10th Cir. 2015).

The facts in *Expert* are relevant to the case at bar. In *Expert*, an LLC held property secured by a $7.75 million first position lien that it sold to a third party named Cornerstone for $3 million. *Id.* at 406, 412. Prior to the $3 million dollar sale, the holder of the deed of trust on the property entered into an agreement whereby an insider of *Expert* had an option to purchase the loan secured by the property for $1,645,108. *Id.* at 404-05. The purchase option was never exercised. *Id.* at 411. The sale contract with Cornerstone required *Expert* to convey clean title, including dismissal of a pending lien foreclosure action. *Id.* at 406. The sale to Cornerstone closed and the secured lender accepted $1,742,170.16 for a release of its lien on the property. *Id.* The parties agreed that the value of the property at the time of the sale was $4.99 million. *Id.* at 407.

The *Expert* court found that the property was not subject to the UFTA[2], because the value of the property was less than the liens "at the time of sale." *Id.* at 412. The *Expert* court in evaluating similar facts held:

> However, the undisputed facts in the present appeal establish that no such compromise took place ***prior*** to the Cornerstone sale closing. The present transaction was, effectively, a "short sale." Such sales are common and involve an agreement by a property lien holder to accept

[2] Oklahoma has adopted the Uniform Fraudulent Transfers Act. *See Expert*, 534 B.R. at 408. RCW 19.40.903 mandates that "this chapter [RCW 19.40 *et seq*] shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this chapter among states enacting it."

> less than full repayment of its loan in exchange for its full release of a property lien in order to facilitate a sale of the secured property. [emphasis added].

Id. The *Expert* court found that "'at the time of sale,' the [property] was subject to a $7.75 million mortgage that exceeded its value, which means it was not an 'asset' under the UFTA." *Id.*

In the instant case, the facts are almost identical, and the Court must look to the value of the lien "at the time of sale." There is no dispute that at the time of closing, April 1, 2008, the lien on the Callaway I assets was $325,000. CP 366-67. Over 20 days after the sale was completed, Humcor used the proceeds of the sale to pay down the debt owed to Cascade Bank and Cascade Bank released its lien on the Callaway I assets only.[3] *Id.* The time gap in this case is even greater than in *Expert* where the funds for the lien release were paid to the secured creditor out of escrow. *Id.* at 406.

The Court must look to the value of the lien at the time of sale in determining the value of the "asset" subject to the fraudulent transfer. There is no authority for trial court to look past the transfer date, and hypothesize that Meridian may have been able to obtain a lien release for less than the full amount of the lien. The Judgment must be vacated and the trial court directed to enter judgment in the net amount of $353,293.96.

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[3] The Cascade Bank debt was not fully satisfied, and Cascade Bank continued to have a lien on Callaway II assets. CP 157.

B. The Trial Court Exceeded Its Statutory Authority By Completely Disregarding The "Valid Lien" In Determining The Value Of The Assets Transferred And Thereby Abused Its Discretion.

The trial court must first properly value the "assets" transferred prior to entering a judgment under RCW 19.40.081(c). The UFTA and its case law is clear that property which is encumbered by a "valid lien" is not an asset subject to the UFTA. *Expert*, 534 B.R. at 412. The Judgment under RCW 19.40.081(c) "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." [emphasis added]. There is no discretion within RCW 19.40.081(c) for the Court to completely disregard "the value of the asset at the time of the transfer" under the value calculation of RCW 19.40.011(2)(i), and impose a new manner of calculating the judgment.

The plain language of the UFTA is clear and unambiguous, an "asset is: (2) 'Asset' means property of a debtor, but the term does not include: (i) Property to the extent it is encumbered by a valid lien; or (ii) Property to the extent it is generally exempt under nonbankruptcy law." RCW 19.40.011(2)(i-ii). Under the statute, a valid lien is any "lien that is effective against the holder of a judicial lien subsequently obtained." RCW 19.40.011(13).

The trial court acted outside its statutory authority in completely disregarding the value of the "valid lien" on the assets, and substituted the amount of cash consideration paid for the assets in determining the value of the assets transferred. The Court did not reduce the value of the property transferred by the amount of the valid lien as required by RCW 19.40.011(2)(i), when it found as a matter of law:

> Judgment should be entered ... in the amount of $560,736.46 which is calculated by the value of the asset transferred at the time of transfer of $750,000 less $75,000 already paid by Mr. Haughney to the plaintiff and less $114,263.54 in cash paid by Loveall to Humcor.

CP 398. The trial court committed reversible error in failing to apply the correct legal standard in determining the "value of the asset transferred." The error in the trial court's reasoning is plainly based upon finding of fact No. 2:

> Cascade Bank stated in writing that it released its lien on the Callaway I equipment so that James Loveall would receive the equipment free and clear of the Bank's lien and in fact the equipment was transferred to James Loveall free and clear of Cascade Bank's lien. Accordingly, the Cascade Bank lien did not diminish the value of the asset transferred to Mr. Loveall.

CP 397. There is no statutory authority for the trial court to value the asset transferred based upon the cash consideration paid, or the "value" received by Mr. Loveall. *See* RCW 19.40.011(2)(i); RCW 19.40.081(c).

There is no mention in the statutory definition of "asset" or "valid lien" the sale price of the property, cash consideration received, the value paid for a lien release, or the value received by the transferee. *See* RCW 19.40.011(2)(i), (13). The statute looks solely to the amount the "valid lien" enforceable against a creditor making the UFTA claim. It is undisputed, that the value of Cascade Bank's "valid lien" on the date of transfer was $325,000, and that Cascade Bank's lien was enforceable against Meridian. CP 336. Meridian's damages under RCW 19.40.081(c) is the amount Meridian could have realized in executing upon the assets or $425,000.

In determining the amount of the damages, there is no discretion under RCW 19.40.011(2)(i) to completely disregard a "valid lien" as the trial court has done in this case. The trial court stepped outside of its statutory authority by replacing the amount of the valid lien with the "consideration" paid for the assets in the calculation of damages, because the trial court felt transferee's value was not diminished by the lien. This is a fundamental rewriting of the statute that can only be undertaken by the legislature. This is an error of law, and must be reversed.

The Judgment must be vacated and remanded to the trial court with instructions to enter judgment in the net amount of $353,293.96.

1. *Meridian's "Economic Reality" Argument Is Not Supported By Facts Or The Law.*

Throughout its brief, Meridian argues that the trial court took into account the "economic realities" to determine the damage suffered by Merdian due to the fraudulent transfer. However, Meridian's argument actually disregards its economic reality. The damage to Meridian is the amount it could have realized had it executed upon the assets on or before the date of transfer. Any execution by Meridian on Callaway I's assets would have been subject to Cascade Bank's $325,000 lien on the property, and any recovery on the assets by Meridian would have been reduced by the full amount of Cascade Bank's lien as of April 1, 2008, the date of transfer. Meridian does not suffer additional damage, because a subsequent lien release is granted for less than full value.

The true economic reality is that Meridian is seeking a windfall in asking this Court to uphold the award of damages based on the lien release. There was no agreement between Cascade Bank and Meridian that Cascade Bank would release its lien for $117,500 after Meridian's

seizure of the assets. Meridian is seeking the entry of a judgment for $210,736.46[4] more than any value it could have realized by executing upon the assets. This would be a windfall to Meridian that is not authorized under the statute. The "economic reality" that Meridian does not want to face is that Meridian's seizure of the assets would have been subject to Cascade Bank's $325,000 lien, and the lien would have reduced Meridian's recovery from the execution by $325,000. The judgment must be vacated and remanded with instructions to enter a judgment in the net amount of $353,293.96 to prevent Meridian from obtaining a windfall.

2. *Meridian's Single Contract Theory Is Irrelevant To The Definition Of An Asset Under RCW 19.40.011(2)(i).*

Meridian argues that this Court should construe the contract for the sale of Callaway I's assets, and the lien release as a single contract. There is no support for this contention factually, or legally. In arguing that the lien release was part of a single transaction, Meridian relies exclusively on extrinsic evidence that is inadmissible to "show an intention independent of the instrument." *See Hollis v. Garwall, Inc.*, 137 Wn.2d 683, 695, 974 P.2d 836 (1999). The purchase and sale agreement includes no condition precedent that Cascade Bank release its lien for $117,500, Trial Ex. No. 1, and to ask the Court to insert such a

[4] This is calculated by taking the $325,000 lien that would have been attached to the property when Meridian executed upon its security interest minus the $114,263.54 figure Meridian is asking the Court substitute as the "valid lien" ($325,000-$114,263.54=$210,736.46).

condition into the purchase and sale agreement using extrinsic evidence violates settled Washington law.[5]

The cases cited by Meridian regarding construing multiple documents as part of a single transaction support the analysis above. In *Lumen v. Pring Corp.*, the Court found the instruments to be ambiguous if read together, because they conveyed two distinct, but overlapping, properties. 4 Wn. App. 462, 467, 482 P.2d 802 (1971). The Court allowed the admission of extrinsic evidence only after finding the contracts to be ambiguous. *Id.* Here, there is no ambiguity in the contracts. One is for the sale of the Callaway I assets at a set price without requiring the lien to be released for a specific price, and the other releases the lien on those assets. Trial Ex. No. 1. The Court's opinion in *Turner v. Wexler* is even less helpful to Meridian. 14 Wn. App. 143, 538 P.2d 877 (1975). The *Turner* decision upholds the trial court's ruling that "the unambiguous terms of the 1969 contract disclose the intent that the 1969 contract modifies the 1965 contract and that only one contract thereafter existed." *Id.* at 145. Meridian does not point to any terms in the purchase and sale agreement, much less any unambiguous terms, that the parties intended the purchase and sale agreement and lien release as part of a single contract. Res. Br.16-19

Most importantly, whether or not the contracts are construed as a single transaction is irrelevant to this Court's analysis of value under RCW 19.40.011(2)(i), and RCW 19.40.081(c). The value paid or received by the transferee does not change the value of the assets under

[5] The reasonable interpretation of the Purchase and Sale Agreement is that if Cascade Bank had refused to release its lien for anything less than full payment, Humcor would have had to pay the loan in full or risk a breach of contract action.

RCW 19.40.011(2)(i). The assets are valued by looking only to the amount of the valid lien against the assets at the time of the transfer. *Id.* It is undisputed, that at the time the sale closed under the purchase and sale agreement, April 1, 2008, the value of the lien enforceable against Meridian was $325,000. Any reduction in the amount of the lien after April 1, 2008[6], is irrelevant under RCW 19.40.011(2)(i).

The Judgment must be vacated and remanded to the Court with instructions to enter judgment in the net amount of $353,293.96.

B. Meridian's Law Of The Case Argument Is Unavailing.

Meridian argues that "the UFTA gave the trial court discretion to adjust the value of Callaway I in light of the Cascade Bank lien, Res. Br.10, and that RCW 19.40.081(c) allows the Court to adjust its damages award 'as the equites may require.'" Res. Br.10-11. This is an accurate description of the Appellate Court's previous decision that has not been challenged. However, that is not what the trial court did in this case in electing to disregard the valid lien and create its own calculation of damages.

In its previous decision, the Appellate Court held: "We recognize that the trial court had authority under RCW 19.40.011(2)(i) and 19.40.081(c) to adjust the damages award downward in light of Cascade Bank's lien on Callaway I." Op. 11, CP 164. The Court found that the downward adjustment of "roughly $325,000" was "statutorily authorized." *Id.* Further, the Court held that the trial court "abused its discretion" by acting outside the statutory authority. Op. 12, CP 165.

[6] In addition, it must be noted that the value of the lien on the property was never reduced to $117,500 just released against specific assets. Op. 157.

The Appellate Court never found the trial court could completely disregard a valid lien in making its damages calculation.

Again, the trial court has applied the incorrect legal standard for calculating the value of an "asset" under RCW 19.40.011(2)(i). The statute is clear and unambiguous that an asset is only those amounts that exceed a valid lien enforceable against the creditor. *See* RCW 19.40.011(2)(i), (13). Further, the trial court abused its discretion in exceeding its statutory authority in holding the consideration paid for the asset, not the amount of the valid lien, is the correct downward adjustment. *See* CP 398. The trial court was not authorized to completely disregard the valid lien on the property. The Appellate Court's holding was that the trial court should adjust the damages downward "in light of Cascade Bank's lien." Op. 11, CP 164. This is consistent with RCW 19.40.011(2)(i). The trial court specifically disregarded the valid lien in holding that "the Cascade Bank lien did not diminish the value of the asset transferred to Mr. Loveall." CP 397. This was simply not a valid consideration under RCW 19.40.011(2)(i).

The law of the case is that the trial court could adjust the damages downward based upon its statutory requirement to reduce asset value based upon a "valid lien." There was no holding that the trial court could unilaterally replace that method for calculating the value of an asset under the statute with its determination the "economic realities" of the transaction warranted a different calculation. The trial court's complete disregard for the valid lien in favor of the cash consideration received for the assets is not supported by the appellate court's decision. In fact, the previous decision finds that the trial court "abuses its discretion" by

acting outside its statutory authority. Op.12, CP 165. That is exactly what occurred on remand.

The Appellate Court's prior decision and RCW 19.40.011(2)(i) requires the amount of valid lien enforceable against Meridian to be subtracted from the asset value. There is no evidence in the record that the $325,000 lien was found to be unenforceable against Meridian at the time of transfer, and the trial court abused its discretion by stepping outside the clear statutory authority and opinion of this Court. The judgment must be vacated and remanded with instructions to enter a net judgment for $353,293.96.

C. Haughney's Appeal Is Not Frivolous.

Meridian requests that this Court award its attorneys' fees and costs under RAP 18.9(a) arguing that Mr. Haughney's appeal is frivolous. This argument is without merit. First, Mr. Haughney's appeal seeks only the relief that was originally granted by the trial court in its oral ruling. *See* CP 366. The trial court later reversed course making its award based upon the "economic realities" of the transaction, which is not provided for under RCW 19.40.011(2)(i) and RCW 19.40.081(c). *Id.* There is a clear legal issue regarding whether the trial court can unilaterally decide the calculation of the value of an asset under RCW 19.40.011(2)(i) is improper given the "economic realities" of the transaction, and apply its own calculation of value.

Further this Court must consider the following in determining whether the appeal was frivolous:

> (1) A civil appellant has a right to appeal under RAP 2.2; (2) all doubts as to whether the appeal is frivolous should be resolved in favor of the appellant; (3) the record should be considered as a whole; (4) an appeal that is affirmed

> simply because the arguments are rejected is not frivolous; (5) an appeal is frivolous if there are no debatable issues upon which reasonable minds might differ, and it is so totally devoid of merit that there was no reasonable possibility of reversal.

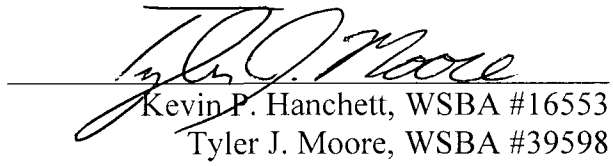
Streater v. White, 26 Wn. App. 430, 435, 613 P.2d 187 (1980). Here it is impossible to say that reasonable minds could not differ regarding the calculation of the value of the assets under RCW 19.40.011(2)(i). As stated above, the trial court reversed itself during the course of the proceedings at the lower court. Further, the position taken by the trial court that the "economic realities" of the transaction trumps the statutory mandate that the value of assets be reduced by the amount of the valid lien on the asset transferred is a debatable legal issue. Mr. Haughney had the right to appeal the trial court's determination that it had the discretion to act outside the plain language of the statutory authority of RCW 19.40.011(2)(i) and RCW 19.40.081(c). The request for attorneys' fees under RAP 18.9(a) is improper and must be denied.

III. CONCLUSION

The trial court has some discretion to adjust the ultimate award under RCW 19.40.081(c), but the trial court did not exercise that discretion in this case. Instead, the trial court applied a method of valuing the assets unsupported by the statute in looking solely to the consideration paid in the transfer, and disregarded the "valid lien" on the property. In doing so, the trial court provided a windfall for Meridian by awarding it a judgment in excess of the amount it could have realized had it seized the assets on the day of the transfer. The rewriting of the statutory valuation of the assets by the trial court is an error of law, and

an abuse of discretion. The judgment must be vacated and remanded with instructions to enter a net judgment for $353,293.96.

Respectfully submitted this 23rd day of November, 2015.



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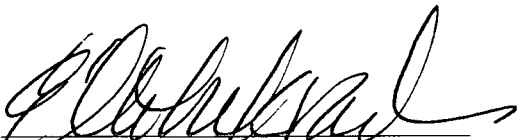

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