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SUPREME COURT
STATE OF WASHINGTON

Supreme Court No. 79875-3
Court of Appeals, Division 1, No. 58927-0

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SUPREME COURT OF THE STATE OF WASHINGTON

CLERK

BEAL BANK, SSB, a Texas State Savings Bank,

Appellant,

v.

STEVEN and KAY SARICH, and the marital community comprised
thereof; JOE CASHMAN and JANE DOE CASHMAN, and the
marital community comprised thereof,

Respondents.

ANSWER TO AMICUS CURIAE BRIEF
BY RESPONDENTS STEVE AND KAY SARICH

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**THERE WILL BE NO IMPACT ON LENDING PRACTICES
IN THE STATE OF WASHINGTON
IF THE TRIAL COURT'S RULING IS AFFIRMED**

Amicus predicts that there will be profoundly negative effects on lending in this state if the trial court is affirmed.¹ This prediction is baseless. Since the *Washington Mutual* case was decided 17 years ago, lending practices in the State of Washington have been based on the rule applied by the trial court in this case. In *Washington Mutual*, this Court held: "We conclude that there is no authority in Washington law for allowing any lienholder to sue for a deficiency following a nonjudicial foreclosure sale."² Commentators agreed that the decision meant what it said, and warned lenders and legal practitioners not to ignore the Court's holding.³

The *Washington Mutual* decision has not been challenged or modified in 17 years. In that time, the lending industry has conducted itself on the assumption that the *Washington Mutual*

¹ Amicus Curiae Brief, p. 14.

² *Wash. Mut. Sav. Bank v. United States*, 115 Wn.2d 52, 55, 793 P.2d 969, 970, clarified on denial of reconsideration, 800 P.2d 1124 (1990).

³ See, e.g., 18 William B. Stoebuck & John W. Weaver, *Washington Practice* § 20.17, at 435-36 (2d ed. 2004); 27 Marjorie Dick Rombauer, *Washington Practice* § 3.37, at 178-79 (1998).

decision means that a lender with a second deed of trust cannot sue the borrower after a foreclosure on the first deed of trust. The marketplace long ago accepted this rule without any adverse consequences. The rule simply provides one more incentive for lenders to make loans that are adequately secured in accordance with responsible lending practices.

Amicus also argues, without support, that “vast amounts of existing debt are at peril” if the trial court decision is affirmed.⁴ Amicus’ rhetoric is dramatic but illogical. Washington lenders have been operating under the *Washington Mutual* rule for nearly two decades. Moreover, the present situation arises only in those instances where a lender makes a mistake in assessing the value of the collateral. Lenders who make such mistakes on a “vast” scale do not remain in business long, and should not look to the Court for protection from the marketplace.

Amicus’ predictions of doom reach a crescendo with the following assertion:

The field of home equity financing and other secondary lending will substantially dry up—to the

⁴ Amicus Curiae Brief, p. 14.

detriment of lenders, borrowers, and the entire housing and commercial real estate industry.⁵

If these concerns were real, the lending industry would have lobbied for legislative change immediately after the *Washington Mutual* case was decided. They did not.

Affirming the trial court will serve the important policy goal of protecting Washington borrowers. Defaulting borrowers have no options. Particularly in the case of deed of trust foreclosures, where there is no judicial involvement, borrowers can be victimized. Recognizing that vulnerability, Washington courts have ruled that the Deed of Trust Act is to be construed in favor of borrowers. See, e.g., *Udall v. T.D. Escrow Services, Inc.*, ___ Wn.2d ___, 154 P.3d 882, 890 (2007).

AMICUS' ARGUMENTS DO NOT SUPPORT REVERSAL OF THE TRIAL COURT

The legal arguments made by amicus are not persuasive. Amicus even admits that it has not found any Washington cases stating that the law is as argued by amicus and Beal Bank.⁶

⁵ Amicus Curiae Brief, p. 16.

⁶ "Although no Washington case has been found confirming the rule that the debt held by a junior lienholder is not extinguished by foreclosure of a senior deed of trust or mortgage lien, . . ." Amicus Curiae Brief, p. 6.

**Washington Law Bars Beal Bank's Claims
Against Steve and Kay Sarich**

Contrary to amicus' argument, Judge McBroom correctly ruled that Washington law bars Beal Bank's claims, relying on *Washington Mutual Savings Bank v. United States*, 115 Wn.2d 52, 793 P.2d 969, *clarified on denial of reconsideration*, 800 P.2d 1124 (1990).

In *Washington Mutual*, this Court held unanimously that a non-foreclosing junior lienholder could not sue a debtor for a deficiency after a nonjudicial foreclosure. The Court explained:

We conclude that there is no authority in Washington law for allowing any lienholder to sue for a deficiency following a nonjudicial foreclosure sale.

* * *

Washington law provides that no deficiency judgment may be obtained when a deed of trust is foreclosed. . . . The parties argue that the statutory bar to deficiency judgments following nonjudicial foreclosures applies only to foreclosing lienholders and not to a nonforeclosing junior lienholder who purchases the property to protect its lien at a nonjudicial foreclosure sale.

* * *

We do not deem it necessary to determine how a deficiency judgment should be measured in this case since we hold here that none may be obtained by a nonforeclosing junior lienor following a nonjudicial

foreclosure sale. There is simply no statutory authority for allowing such a judgment following a nonjudicial, or deed of trust, foreclosure.

Washington Mutual, 115 Wn.2d at 55 and 58, 793 P.2d at 970 and 972. In a concurring opinion, Justice Guy asserted that “where a junior deed of trust holder does not foreclose, that junior deed of trust holder is not precluded from suing under the note.”

Washington Mutual, 115 Wn.2d at 60, 793 P.2d at 973. Justice Guy’s assertion is *contrary* to the Court’s holding. No other justice joined in the concurring opinion. *Washington Mutual* moved for reconsideration. The motion was denied, unanimously, with a clarification that Justice Guy’s assertion regarding the rights of a junior lienholder was not part of the Court’s opinion: “We do not herein address the matter of a junior deed of trust holder’s continued right to sue the debtor on the promissory note because it is not before us.” *Washington Mutual*, 800 P.2d 1124 (1990).

Even after the clarification, this Court’s holding in *Washington Mutual* was widely acknowledged to mean that a junior lienholder could not sue on its note after the foreclosure of a senior

lienholder.⁷ Lender advocates argued that the Court's decision would have a "chilling effect" on lenders,⁸ and called for legislative action to protect non-foreclosing junior lienholders. In January 1992, the Washington Law Review published a pro-lender analysis of the *Washington Mutual* decision. The author argued:

In *Washington Mutual Savings Bank v. United States*, the Washington Supreme Court extended the anti-deficiency provisions of the Deed of Trust Act to all non-foreclosing junior lienors. *Because this decision makes all junior obligations uncollectible following a nonjudicial foreclosure, it may have a chilling effect on lenders*

* * *

The Washington Legislature should amend the anti-deficiency provisions specifically to exempt the non-foreclosing junior lienor. Section 61.24.100 of the Revised Code of Washington should be changed to read: "Foreclosure . . . shall satisfy the obligation secured by the deed of trust foreclosed, but not a lien or mortgage or trust deed junior to the one foreclosed"⁹

⁷ See, e.g., John D. Sullivan, *Rights of Washington Junior Lienors in Nonjudicial Foreclosure – Washington Mutual Savings Bank v. United States*, 115 Wash.2d 52, 793 P.2d 969, clarified, reconsideration denied, 800 P.2d 1124 (Wash. 1990), 67 Wash. L. Rev. 235, at 235 (January 1992); Stoebuck & Weaver, *supra* note 3, at 435; Rombauer, *supra* note 3, at 178-79.

⁸ Sullivan, *supra* note 7, at 235.

⁹ Sullivan, *supra* note 7, at 235 and 254-55 (emphasis added). See also Stoebuck & Weaver, *supra* note 3, at 435 ("Obviously, either the Washington State Supreme Court or the state legislature needs really to "clarify" the *Washington Mutual* decision. Taken literally, it means that the holder of every lien junior to a deed of trust in Washington, which of course includes many commercial lenders, must buy at the trustee's sale or lose everything").

In spite of the long-ago calls for legislative action, the Washington legislature has not changed the Deed of Trust Act to protect junior lienholders from the anti-deficiency provisions of the Act. Contrary to the “sky is falling” predictions of the lender advocates, the lending industry has not suffered any ill effects based on the 17-year-old *Washington Mutual* decision.

This Court recently refused to void a non-judicial foreclosure sale even though the sale price was significantly lower than the amount of the debt (the auctioneer mistakenly opened the bidding \$100,000 lower than the amount authorized by U.S. Bank). *Udall, supra*. Citing the *Washington Mutual* case, this Court explained that the borrower’s interests were not harmed by the low price *because there could be no deficiency judgment*:

T.D.’s delivering of the deed of trust to Udall does not injure the borrower’s interests, because the debt secured by the deed of trust is per se satisfied by the foreclosure sale due to the Act’s antideficiency provision.^{Fn8}

^{Fn8} “Washington law provides that no deficiency judgment may be obtained when a deed of trust is foreclosed.” *Wash. Mut. Sav. Bank v. United States*, 115 Wn.2d 52, 58, 793 P.2d 969, 800 P.2d 1124 (1990).

Udall, __ Wn.2d at __, 154 P.3d at 890. Clearly, a borrower's interest could be harmed by a low price if a junior lienholder could obtain a deficiency against the borrower. The Court's decision in *Udall* is consistent with its ruling in *Washington Mutual* that "there is no authority in Washington law for allowing *any* lienholder to sue for a deficiency following a nonjudicial foreclosure sale."¹⁰

**Amicus' Argument Based On
Release or Abandonment Of Security
Has No Merit**

Citing two cases decided *before* the enactment of the Deed of Trust Act in 1965, amicus asserts that "Washington courts have held that the extinguishment of a lien by *waiver* or *release* does not extinguish the debt secured thereby."¹¹ Without citing any additional authority, amicus then argues:

Likewise, when the non-foreclosing holder of a junior deed of trust elects not to bid at the foreclosure sale of a senior deed of trust, that junior lienholder is in effect *abandoning* its security and electing to pursue an action on the debt. Accordingly, whether the abandonment of the security is by waiver or release, or whether it occurs through operation of the foreclosure process, the result should be the same.¹²

¹⁰ *Washington Mutual*, 115 Wn.2d at 55, 793 P.2d at 970 (emphasis added).

¹¹ Amicus Curiae Brief, p. 6 (original emphasis).

¹² Amicus Curiae Brief, pp. 6-7 (original emphasis).

Amicus' argument is flawed. By failing to bid at the foreclosure sale, the junior lienholder is *not* abandoning its security. The Deed of Trust Act specifically provides that a junior lien attaches to any surplus proceeds of the foreclosure sale in the same priority that the lienholder had in the property. RCW 61.24.080(3) ("Interests in, or liens or claims of liens against the property eliminated by sale under this section shall attach to the surplus in the order of priority that it had attached to the property"). Beal was not abandoning its security by electing not to bid on the property. To the contrary, Beal was holding on to its deeds of trust and the rights they provided to any surplus proceeds from the foreclosure sale.

Beal Bank could have released its security, but chose not to do so. When the senior lienholder provided notice of the foreclosure sale, Beal made a choice to keep its security and participate in the foreclosure process as a junior lienholder. The

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result was a lower sale price for the property,¹³ and a bar to any deficiency judgment against the Sariches.

Amicus contends that Beal Bank is not seeking a deficiency judgment against the Sariches. Amicus is wrong. Any lienholder who seeks to recover debt remaining after application of the proceeds of the foreclosure sale is seeking a deficiency judgment. This is true whether or not the lienholder is the foreclosing party, and whether or not there are sufficient funds remaining to pay a non-foreclosing lienholder.¹⁴ The Deed of Trust Act makes no exception for non-foreclosing lienholders. To the contrary, the statute expressly provides for distribution of sale proceeds to non-foreclosing lienholders. RCW 61.24.080(3). Any leftover debt is a

¹³ The condominium was worth \$2.5 million according to Beal's analysis. CP 284. The senior lienholder's debt was approximately \$1.6 million. CP 149. Beal's debt was approximately \$700,000. With Beal's liens in place, there was relatively little equity in the property to attract potential bidders (approximately \$200,000). If Beal had released its liens, there would have been approximately \$900,000 of equity in the property, making it much more attractive to potential bidders. In fact, Beal did not release its liens, and the property attracted no bidders other than the senior lienholder. The senior lienholder purchased the property at the foreclosure sale for the amount of its debt. CP 156. Beal's decision not to release its liens before the sale prevented the sale price from being bid up by the additional bidders likely to be attracted by approximately \$900,000 of equity.

¹⁴ For example, if the property had sold at foreclosure for a price that exceeded the senior lienholder's debt and led to a distribution of \$100 to Beal Bank as the second lienholder, it would be clear that the difference between what Beal claimed to be owed and the \$100 received from the foreclosure would be characterized as a deficiency. There is no rational distinction to be made between a distribution of zero dollars and a distribution of \$100.

deficiency, recovery of which is barred by Washington law.

**The Deed of Trust Act Must Be Construed
In Favor of the Borrower**

Under Washington law, the Deed of Trust Act must be construed in favor of the borrower:

The Act must be construed in favor of borrowers because of the relative ease with which lenders can forfeit borrowers' interests and the lack of judicial oversight in conducting nonjudicial foreclosure sales.

Udall, ___ Wn.2d at ___, 154 P.3d at 890. *See also Amresco*

Independence Funding, Inc. v. SPS Properties, LLC, 129 Wn. App. 532, 536-37, 119 P.3d 884, 886 (2005) ("Because these statutes remove many protections borrowers have under a mortgage, lenders must strictly comply with the statutes, and courts must strictly construe the statutes in the borrower's favor").

In *Thompson v. Smith*, 58 Wn. App. 361, 793 P.2d 449 (1990), the court held that the grantor of a deed of trust (Smith) was entitled to the anti-deficiency protections of RCW 61.24.100, even though the beneficiary (Thompson) did not foreclose under RCW 61.24. By accepting a deed in lieu of foreclosure from a third party (Israel), the court held that Thompson was barred from

seeking a deficiency from Smith. The court explained:

Here, by accepting the deed in lieu of foreclosure from Israel and then privately selling the property, Thompson essentially carried out a nonjudicial foreclosure without having to follow the statutory procedures of RCW ch. 61.24. Had he foreclosed nonjudicially pursuant to the statute, he would have been barred from seeking a deficiency judgment on the underlying obligation. Given the policies underlying RCW ch. 61.24, we can find no authority for permitting Thompson to obtain through self-help that which he could not accomplish pursuant to RCW ch. 61.24. Under the specific circumstances of this case, Smith is entitled to the protection of RCW 61.24.100.

We are not persuaded by Thompson's argument that RCW ch. 61.24 is inapplicable simply because he accepted the deed in lieu of foreclosure from Israel rather than Smith. *The circumstances here underscore the potential for mischief that would arise if creditors are permitted to circumvent the few statutory requirements imposed by RCW ch. 61.24.*

Thompson, 58 Wn. App. at 366, 793 P.2d at 451 (emphasis added).

Beal Bank (and amicus) argue that the *Washington Mutual* decision should be limited to non-foreclosing junior lienholders who purchase the property at the foreclosure sale. But if the Court endorses that distinction, lenders who have not obtained adequate security will be discouraged from purchasing the property at foreclosure – particularly if they believe (rightly or wrongly) that

the borrower has other assets. Any excess value in the collateral would be forfeited to the purchaser (usually the senior lienholder) to the detriment of the borrower. The ruling sought by Beal Bank would encourage lower foreclosure prices (inefficiency in the foreclosure process), waste of collateral, and prejudice to the borrower. Any interpretation of the Deed of Trust Act so clearly hostile to borrowers would be contrary to Washington law.

**The 1998 Amendments To the Deed of Trust Act
Do Not Support Amicus' Argument**

Eight years after the *Washington Mutual* decision, the Washington legislature amended the Deed of Trust Act without adopting any protections from the anti-deficiency provisions for junior lienholders. The "Executive Summary of 1998 Proposed Amendments to the Washington Deed of Trust Act" establishes that the 1998 amendments did not address this Court's decision in the *Washington Mutual* case.¹⁵ The care and thought that went into the drafting of the 1998 amendments is described in the Executive Summary, which states:

¹⁵ A copy of the "Executive Summary of 1998 Proposed Amendments to the Washington Deed of Trust Act," dated January 16, 1998 ("Executive Summary") was submitted to the Court as an Addendum to Amicus Curiae Brief.

The 1998 proposed amendments to the Washington Deed of Trust [Act] are the work product of the persons whose names and affiliations are set forth on Exhibit A to this Executive Summary.¹⁶ That group was chaired by Gordon W. Tanner, immediate past-Chair of the Washington State Bar Association Real Property Probate and Trust Section. It was formed at the suggestion of John Gose to Gordon Tanner by gathering interested attorneys whose practices emphasize commercial, residential and consumer lending practices following the veto of Senate Bill 5554 by Governor Locke for lack of enough exposure and comment, after that Bill was passed in 1997. The foundation for these new amendments was SB 5554, but **the committee** went well beyond that proposal and **undertook a complete review of the existing law found at RCW 61.24**. Many of the proposed changes are technical in nature and are needed to clarify questions in the existing law.

This proposed bill has been studied extensively by all relevant interest groups, incorporates many suggestions from a broad spectrum of practitioners, is based on the principle that if a consensus within the working group developed the suggestions were included, without requiring unanimous support, amends 12 of the 14 sections of the existing law, and adds 4 new sections. It is sponsored by the Washington State Bar Association after review, hearings and approval for sponsorship by the WSBA Real Property Council and the full WSBA Real Property Probate and Trust Executive Committee, the WSBA Legislative Committee and the WSBA Board of Governors. **It has also been circulated**

¹⁶ The persons listed on Exhibit A include lawyers from such highly regarded firms as Stoel Rives; Davis Wright Tremaine (present counsel for amicus); Bogle & Gates; Winston & Cashatt (counsel for appellant Beal Bank), Perkins Coie; Preston Gates & Ellis; Graham & Dunn; Garvey, Schubert & Barer; Heller Ehrman White & McAuliffe; Witherspoon, Kelley, Davenport & Toole; Foster Pepper & Shefelman; and Hillis, Clark, Martin & Peterson.

to interested groups, including . . . Washington Mortgage Lenders (sponsors of SB 5554), Washington Credit Union League, and Washington Bankers Association.¹⁷

The Executive Summary describes the proposed changes in the Deed of Trust Act, including the anti-deficiency provisions contained in RCW 61.24.100. The portion of the Executive Summary addressing the changes proposed to RCW 61.24.100 does not mention the *Washington Mutual* case or any concerns regarding non-foreclosing junior lienholders. Executive Summary, pp. 4-6.

The 1998 amendments do not protect junior lienholders from the anti-deficiency provisions of the Act. Amicus' arguments to the contrary have no merit. When John Sullivan wrote his law review article about the *Washington Mutual* decision 15 years ago, he suggested plain language to protect junior lienholders:

"Foreclosure . . . shall satisfy the obligation secured by the deed of trust foreclosed, *but not a lien or mortgage or trust deed junior to the one foreclosed . . .*"¹⁸ No such language has been adopted.

¹⁷ Executive Summary, p. 1 (emphasis added). The listed organizations are three of the five pro-lender associations appearing as amicus in the present case.

¹⁸ Sullivan, *supra* note 7, at 254-55 (emphasis added).

**The Washington State Bar Association Refused to Submit
An Amicus Brief Supporting Beal Bank's Position**

The Washington State Bar Association sponsored the 1998 amendments to the Deed of Trust Act.¹⁹ Beal Bank asked the WSBA to file an amicus brief supporting Beal's position in this case. The WSBA refused. Beal sent its request to the chairs of the WSBA Amicus Brief Committee, the WSBA Real Property Section, the WSBA Creditor-Debtor Section, and the WSBA Taxation Section. The WSBA rejected Beal Bank's request at every level, including the Board of Governors.

CONCLUSION

Judge McBroom properly applied Washington law to reach a just result. The Sariches respectfully ask this Court to affirm the decision of the trial court.

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¹⁹ Executive Summary, p. 1.

DATED this 11th day of May, 2007.

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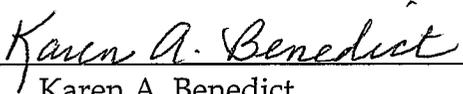
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