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JUL 31 2008

No. 81833-9

CLERK OF SUPREME COURT
STATE OF WASHINGTON

SUPREME COURT OF THE STATE OF WASHINGTON

N. JACK ALHADEFF, *Plaintiff/Respondent*,

v.

KITSAP COMMUNITY FEDERAL CREDIT UNION dba KITSAP CREDIT UNION,
Defendant/Petitioner.

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STATE OF WASHINGTON
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ANSWER TO PETITION FOR REVIEW

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ORIGINAL

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I.

IDENTITY OF RESPONDENT

N. Jack Alhadeff, plaintiff in the trial court, appellant in the Court of Appeals, is the respondent to the petition for review of Kitsap Community Federal Credit Union (“KCU”).

II.

COURT OF APPEALS DECISION

The decision with respect to which KCU seeks discretionary review is *Alhadeff v. Kitsap Community Federal Credit Union*, No. 36340-2-II, Court of Appeals, Div. II, June 3, 2008 (the “Decision”).

III.

COUNTERSTATEMENT OF THE ISSUES

1. Does the petition for review of the Court of Appeals’ decision that the one-year statute of limitations under RCW 62A.5-115 applies only to claims that arise under Article 5 of the Uniform Commercial Code involve an issue of substantial public interest that should be decided by this Court?

2. Does the petition for review of the Court of Appeals’ decision that the one-year statute of limitations under RCW 62A.5-115 does not apply to Mr. Alhadeff’s claims, because they do not arise under Article 5 of the

Uniform Commercial Code, involve an issue of substantial public interest that should be decided by this Court?

3. Does the petition for review of the Court of Appeals' decision that a letter of credit itself cannot be the agreement to which the beneficiary's warranty under RCW 62A.5-110(1)(b) applies involve an issue of substantial public interest that should be decided by this Court?

4. Does the petition for review of the Court of Appeals' decision that the holding in *Krause v. Stroh Brewery Co.*, 240 F. Supp. 2d 632 (E.D. Mich. 2002), which is of no precedential value, is contrary to the principles underlying Article 5 of the Uniform Commercial Code, involve an issue of substantial public interest that should be decided by this Court?

IV.

COUNTERSTATEMENT OF THE CASE

A. KCU Makes Construction Loan To Meridian

This action arises out of a construction loan (the "Construction Loan") made by Kitsap Community Federal Credit Union, doing business as Kitsap Credit Union ("KCU"), on June 27, 2003 to The Meridian On Bainbridge Island, LLC ("Meridian") to build a condominium project on Bainbridge Island known as The Meridian On Bainbridge Island (the "Project"). CP 61;

¶ 2. When KCU made its loan, the total cost to complete the Project was \$6,565,451, of which \$2,095,293 had already been paid by Meridian. *Id.* KCU made a loan of \$4,500,000. *Id.* A total of \$5,460,000 was needed by Meridian in order to complete construction of the Project. *Id.* One condition of KCU's loan commitment was that Meridian contribute additional funds for the Project by means of an irrevocable letter of credit in the amount of \$1,000,000.00 (the "LOC") to be issued to KCU. *Id.* Upon drawing on the LOC, the funds were to be disbursed by KCU to Meridian as if they were additional loan proceeds to be used by Meridian solely for development and construction of the Project. Together with KCU's loan proceeds of \$4.5 million, the LOC proceeds would cover the \$5,460,000 needed to complete construction of the Project under the budget approved by KCU. *Id.*

B. Alhadeff Provides Letter Of Credit

Upon the terms and conditions set forth in that certain Letter of Credit Agreement (the "LOC Agreement") with Meridian, Mr. Alhadeff caused his bank, Wells Fargo Bank, N.A. ("Wells Fargo") to provide to KCU the LOC in the amount of \$1 million, for the benefit of Meridian. CP 61; ¶ 3. Upon Mr. Alhadeff's request, on July 2, 2003, Wells Fargo issued the LOC, No. NZS488105, to KCU. *Id.*

C. KCU/Alhadeff Agreement

Prior to entering into the LOC Agreement with Meridian, Mr. Alhadeff asked KCU for a letter agreement setting forth the terms and conditions upon which he could rely in funding the LOC, *i.e.*, the consideration he was to receive from KCU in return for agreeing to fund the LOC. CP 61; ¶ 4. Mr. Alhadeff's attorney submitted a proposed letter agreement to KCU for its signature on June 27, 2003, which contained, *inter alia*, the following two provisions:

3. Kitsap Credit Union shall not draw upon the Letter of Credit in the event the Borrower is in default under the Construction Loan or an event exists that may, with the passage of time, constitute a default under the Construction Loan.

...

5. All amounts otherwise available for disbursement to Borrower shall be paid to you until you are paid in full. In addition, ten percent (10%) of the net proceeds from the sale of any portion of the Project shall be released to you in payment of the amounts owed by the Borrower to you.

CP 61-62; ¶ 4. On July 2, 2003, Douglas B. Chadwick, KCU's Director of Commercial Lending, sent Mr. Ross a revised letter agreement that did not contain paragraphs 3 and 5 set out above. In the accompanying email, Mr. Chadwick explained the exclusion of the subject paragraphs as follows:

2. Paragraph #5. We have eliminated this paragraph and suggest that the 10% net proceeds on the sale of units that was designated to Meridian be assigned by Meridian back to Jack. This is much cleaner for us and we would honor that assignment. Using an assignment is a better method for us.

3. Paragraph # 3 [sic] On each request for draws under the Letter of Credit we are required to affirm that there are no events of default and think this is sufficient protection.

CP 62; ¶ 4. In reliance on Mr. Chadwick's July 2, 2003 email, a copy of which is attached as CP 71-72, together with the Letter Agreement dated July 1, 2003, a copy of which is attached as CP 73-74, Mr. Alhadeff agreed to fund the LOC.

D. Assignment of 10% of Net Proceeds

The LOC Agreement between Mr. Alhadeff and Meridian provides that ten percent (10%) of the net proceeds from the sale of any portion of the Project, that was otherwise payable at closing to Meridian, was to be paid to Mr. Alhadeff in payment of amounts owed to him by Meridian. CP 62; ¶ 5. As a result of this assignment of proceeds, and KCU's agreement to honor such assignment, as described above, Mr. Alhadeff had an absolute right to payment of ten percent (10%) of the net proceeds from the sale of any portion of the Project. *Id.* KCU breached this agreement and did not pay Mr. Alhadeff 10% of the net proceeds.

**E. KCU Makes Draws On LOC, Each Time Falsely Certifying That
The Construction Loan Was Not In Default**

On May 11, 2004, KCU presented its sight draft to Wells Fargo on the LOC in the amount of \$415,000.00, which was accompanied by a letter of the same date, signed by Brett Jorgenson, Senior Vice President of KCU, which included the following certification:

The undersigned, an authorized officer of Kitsap Community Federal Credit Union, ("Kitsap") hereby certifies, under penalty of perjury, that all funds have been advanced (less any interest reserve) to the Meridian on Bainbridge Island, LLC (the "Borrower") under or in connection with that certain construction loan promissory note (the "Note") dated as of June 27, 2003 in the aggregate amount of \$4,500,000 established by Kitsap in favor of borrower, an "Event of Default" (as defined in the Note) has not occurred, no event exists that may, with the passage of time, constitute an "Event of Default", Borrower is currently not in default, . . . and Kitsap is now drawing the sum of \$415,000.

CP 63; ¶ 6. (Copies of this sight draft and accompanying letter are attached as CP 107-09).

On June 11, 2004, KCU presented its sight draft to Wells Fargo on the LOC in the amount of \$474,850.00, which was accompanied by a letter of the same date, signed by Mr. Jorgenson, which contained the same certification set out above, except for the last clause, which read as follows:

"and Kitsap is now drawing the sum of \$474,850. CP 63; ¶ 7. (Copies of this

sight draft and accompanying letter are attached as CP 110-12).

On July 8, 2004, KCU presented its sight draft to Wells Fargo on the LOC in the amount of \$110,150.00, which was accompanied by a letter of the same date, signed by Mr. Jorgenson, which contained the same certification set out above, except for the last clause, which read as follows: "and Kitsap is now drawing the sum of \$110,150." With this third draw, the entire LOC was drawn upon. CP 63; ¶ 8. (Copies of this sight draft and accompanying letter are attached as CP 113-15).

KCU's Director of Commercial Lending, Doug Chadwick, admitted in his deposition that KCU had incorrectly certified to Wells Fargo Bank on each of its three draw requests on the LOC that there were no events of default under the Construction Loan, when it knew that events of default had, in fact, occurred. CP 96-8. Thus, KCU admitted that each of its three certifications to Wells Fargo contained gross misrepresentations of fact and that KCU's own files reveal its knowledge of the defaults at the time of each of the three draws on the LOC.

F. Meridian Changes the Scope of the Project

Doug Chadwick also testified at his deposition, that as early as April 2004, but certainly before May 11, 2004, the date of KCU's first draw on the

LOC, with the approval of KCU, Meridian had changed the scope of the Project, with a revised budget at least a million dollars greater than the construction budget on which KCU's \$4,500,000 loan was based, and had already commenced to incur construction costs that were beyond Meridian's ability to pay. CP 99-101. The changes in the scope of the project added in excess of \$1 million to the cost to complete the Project. CP 64; ¶ 9.

G. No One Advises Alhadeff of Changes in the Scope of the Project

Mr. Alhadeff did not learn of the changes in the scope of the Project, or the increased costs that were being incurred by Meridian, until long after KCU drew all the funds on the LOC. CP 64; ¶ 10. If he had known of the changes and increased costs, Mr. Alhadeff would have been able to protect his interests by ensuring that draw requests made on the LOC he had funded would be based upon accurate representations by KCU to Wells Fargo and, if necessary, by taking action to prevent Wells Fargo from honoring draw requests based on false or fraudulent certifications. *Id.* The two KCU employees who administered the Construction Loan—Doug Chadwick, Director of Commercial Lending and Brett Jorgenson, Senior Loan Officer—admitted in their depositions that they could not recall advising plaintiff of the change in scope and increased costs at any time prior to July

8, 2004, the date of KCU's last draw on the LOC. *Id.* By that point, the funds Mr. Alhadeff provided through the LOC to Meridian to pay construction costs had been expended, primarily to protect the first position deed of trust of KCU. *Id.*

H. Meridian Applies For Additional Loan From KCU

When KCU took its three draws on the LOC, the Construction Loan was fully disbursed and Meridian was already in default under the Construction Loan and without funds to complete the Project. CP 64; ¶ 11. By September 2004, Meridian owed in excess of \$1.1 million in unpaid invoices for work done on the Project. *Id.* Meridian requested KCU to provide additional funding. *Id.* The Project's costs to completion were estimated by KCU to have increased an additional \$2,178,895. *Id.* KCU agreed to advance to Meridian an additional \$1,350,000, with the estimated \$828,895 in additional funds needed to complete the Project to be paid by Meridian from other sources. *Id.* On September 30, 2004, Meridian executed an additional note to KCU in the principal amount of \$1,350,000. *Id.*

I. KCU Declares Default On The Construction Loan

On November 29, 2006, KCU formally declared the Construction Loan to be in default. On April 9, 2007, Mr. Alhadeff received a Notice of

Trustee's Sale under KCU's first position deed of trust against the eleven remaining unsold condominium units in the Project. CP 65; ¶ 12.¹ Mr. Alhadeff understands that Meridian has no assets other than the Project itself. *Id.* Although the members of Meridian are parties to this lawsuit, their guaranty of Meridian's obligations to Mr. Alhadeff under the Letter of Credit Agreement are limited to their membership interest in Meridian. *Id.* Thus, because of KCU's alleged breaches of contract, misrepresentation and negligence in the way it drew down the LOC and administered the Construction Loan, the Project, although completed, became a financial disaster for Mr. Alhadeff. *Id.* There appears to be little prospect of Mr. Alhadeff being paid the approximately \$1,700,000.00 he is owed by Meridian under the LOC Agreement.

J. Plaintiff's Claims Against KCU

Mr. Alhadeff asserted eight causes of action against KCU, including common-law breach of contract, tort and equitable claims.

¹The Trustee's sale was scheduled for July 6, 2007, then continued to July 27, 2007. On July 25, 2007, *i.e.*, after the hearing on KCU's motion for summary judgment in the court below, Meridian filed a petition for relief under Chapter 11 of the United States Bankruptcy Code in the U. S. Bankruptcy Court for the Western District of Washington, Case No. 07-13408. Meridian's Chapter 11 filing did not affect the ongoing litigation, including this appeal, against any party other than Meridian. The Chapter 11 case was dismissed on November 15, 2007 and the remaining unsold units in the Project have been sold in a nonjudicial foreclosure sale.

K. Procedural History

On August 30, 2006, Mr. Alhadeff filed his Amended Complaint For Damages For Breach Of Contract, Negligence, Conversion, etc. KCU answered the Amended Complaint and subsequently filed its Motion for Summary Judgment, CP 23-26, which was heard on April 27, 2007. On May 14, 2007, the trial court entered its Order Granting Motion Of Defendant Kitsap Community Federal Credit Union For Summary Judgment, CP 145-47, which order was certified as a final order under CR 54(b). On June 3, 2008, the Court of Appeals issued its decision reversing the trial court's dismissal of Mr. Alhadeff's claims and remanding the matter to the trial court. The petition for review followed.

L. Summary Of Court Of Appeals' Decision

KCU's sole argument on summary judgment can be summarized as follows: 1) all of the causes of action asserted against it by Mr. Alhadeff arise under Article 5 of the Uniform Commercial Code, RCW 62A.5-101, *et seq.*; 2) the statute of limitations for actions under Article 5 is one year; 3) this lawsuit was filed more than one year after Mr. Alhadeff's causes of action accrued. As a consequence, KCU argued, all of Mr. Alhadeff's causes of action against KCU are time-barred. The trial court accepted KCU's

argument and summarily dismissed all of Mr. Alhadeff's claims against it.

The Court of Appeals concluded that none of Mr. Alhadeff's claims arises under Article 5 of the UCC and, as a result, his claims are not time-barred under RCW 62A.5-115.

V.

ARGUMENT

A. Considerations Governing Acceptance Of Review

RAP 13.4(b) provides as follows:

(b) Considerations Governing Acceptance of Review. A petition for review will be accepted by the Supreme Court only: (1) If the decision of the Court of Appeals is in conflict with a decision of the Supreme Court; or (2) If the decision of the Court of Appeals is in conflict with another decision of the Court of Appeals; or (3) If a significant question of law under the Constitution of the State of Washington or of the United States is involved; or (4) If the petition involves an issue of substantial public interest that should be determined by the Supreme Court.

RAP 13.4(c)(7) requires that a petition for review contain, *inter alia*, "A direct and concise statement of the reason why review should be accepted under one or more of the tests established in section (b), with argument."

KCU's statement of the reason it contends review should be accepted, **and** the **entire** argument therefor, consists of the following paragraph:

This Court should accept review because the issue presented is of substantial public interest. It is a case of first impression in Washington, and the decision of the Court of Appeals conflicts with the only other reported decision addressing the issue. That case correctly holds that UCC Article 5's one-year statute of limitations prevents a party from bringing causes of action in contract, tort or equity which could have been brought as a breach of warranty cause of action arising under Article 5.

Petition, p. 3. KCU's statement/argument for acceptance of review is not a model of clarity. The Petitioner appears to be saying that one reason for acceptance of review is that "the issue presented is of substantial public interest," although KCU does not specify which of the four issues it presented for review is **the** "issue" to which it is referring. Then, presumably to satisfy the requirement of RAP 13.4(b)(4)--that the purported "issue of substantial public interest" be one "that should be determined by the Supreme Court"--KCU points out that "[i]t is a case of first impression."

KCU also appears to argue that another reason for acceptance of review is that "the decision of Court of Appeals conflicts with the only other reported decision addressing the issue." A conflict with the decision in *Krause v. Stroh Brewery Co.*, 240 F. Supp. 2d 632 (E.D. Mich. 2002), is not, of course, among the four tests included in RAP 13.4(b). Perhaps, KCU means to suggest that the alleged conflict of the Court Appeal's decision with

that of a decision of a trial judge sitting in the U. S. District Court for the Eastern District of Michigan is a matter of substantial interest to the people of the State of Washington that should be decided by this Court under RAP 13.4(b)(4). If the latter is KCU's position, it is without merit.

B. KCU Has Failed To Satisfy The Requirements Of RAP 13.4(b)

KCU seems to argue that review of the decision of the Court of Appeals is warranted under RAP 13.4(b)(4) because the case involves a matter of first impression in the State of Washington and conflicts with a decision from another jurisdiction which is of no precedential value in the State of Washington.² Mr. Alhadeff submits this case does **not** involve an issue of "public interest," much less an issue of **substantial** public interest that should be determined by this Court.

First, a definition is in order. "Public interest" is defined in *Black's Law Dictionary* 1244 (7th ed. 1999) as follows:

1. The general welfare of the public that warrants recognition and protection.
2. Something in which the public as a whole has a stake; . . .

The issues involved in this litigation arise in the context of a private

²Pages 4 through 17 of the Petition For Review contain nothing more than argument that was submitted by KCU in its brief to the Court of Appeals or a discussion of the merits of the Court of Appeals' decision, none of which is relevant to the sole issue in this proceeding, *i.e.*, whether KCU has satisfied the requirements of RAP 13.4(b).

dispute, between private parties engaged in commerce--a credit union, on the one hand, and a private lender, on the other--with respect to the development by a private company--Meridian--of commercial real estate. One can hardly imagine a dispute that is **less** involved with matters of the "general welfare of the public" or matters in which "the public as a whole has a stake." This case implicates the financial interests of private parties, interests in which the "public as a whole" has no stake whatsoever.

This Court does not appear to have defined in a reported decision what "an issue of substantial public interest" means for purposes of RAP 13.4(b)(4). This Court has given examples, however, of what it considers to be such an interest. In *In re Marriage of Ortiz*, 108 Wn.2d 643, 740 P.2d 843 (1987), this Court addressed the issue of whether its prior decision in *In re Marriage of Edwards*, 99 Wn.2d 913, 665 P.2d 883 (1983), approving escalation clauses in child support awards, applied retroactively. The trial court determined that *Edwards* did not apply retroactively. The Court of Appeals reversed, ruling that *Edwards* applied retroactively and that the noncustodial parent in *Ortiz* was entitled to repayment from the custodial parent of all payments made by the noncustodial parent pursuant to an invalid escalation clause in a child support decree. This Court determined that the

case involved an issue of substantial public interest and granted review. The issue was framed as follows:

[Because] the escalation clause in the child support part of the dissolution decree does not comport with the requirements of *In re Marriage of Edwards*, 99 Wash.2d 913, 665 P.2d 883 (1983), did the trial court err in holding that: (a) the holding in *Edwards* is not retroactive; (b) the escalation clause was voidable, rather than void; and (c) the noncustodial parent is not entitled to reimbursement of the support moneys he paid pursuant to the requirements of the escalation clause?

In re Marriage of Ortiz, 108 Wn.2d 643, 646, 740 P.2d 843 (1987). This Court explained the nature of the “substantial public interest” involved in *Ortiz* as follows:

For most people with children who go through a marriage dissolution, child support is often the most significant issue because the duty of child support does not terminate when the final decree of dissolution is entered. When a fixed dollar amount of child support is awarded, as has traditionally been the case, the award can rapidly become obsolete in the face of inflation. As a result, the custodial parent must either repeatedly return to court to seek modification of the support decree, which results in additional attorneys' fees, court congestion, and emotional trauma, or face the prospect of increasingly inadequate support. That, and the usually increasing financial needs of children as they grow up, were two of the strong policy reasons cited by this court when it approved the use of escalation clauses and percentage of income awards in *Edwards*.

Id., 108 Wn.2d at 646-47 (citations omitted).

Similarly, in *State v. Watson*, 155 Wn.2d 574, 122 P.3d 903 (2005),

a case involving sentencing of drug offenders, this Court said as follows:

We may grant review and consider a Court of Appeals opinion if it “involves an issue of substantial public interest that should be determined by the Supreme Court.” RAP 13.4(b)(4). **This case presents a prime example of an issue of substantial public interest. The Court of Appeals holding, while affecting parties to this proceeding, also has the potential to affect every sentencing proceeding in Pierce County after November 26, 2001, where a DOSA sentence was or is at issue.** Although the Court of Appeals reasoning would require remand only if the policy letter were kept 'secret,' it invites unnecessary litigation on that point and creates confusion generally. *See id.* Further, the court's treatment of communications as ex parte in later proceedings has the potential to chill policy actions taken by both attorneys and judges--they may fear that their statements or actions in various public roles would later be treated as ex parte communications.

Id., 155 Wn.2d at 577 (footnote omitted; emphasis added).

Washington courts often have addressed the issue of what constitutes a matter of “continuing and substantial public interest” for purposes of an exception to the mootness doctrine. In a case involving six linked appeals, Division One of the Court of Appeals, in *In re the Matter of the Interest of M.B.*, 101 Wn. App. 425, 3 P.3d 780 (2000), first had to resolve whether the cases should be reviewed on their merits despite the fact that they were all technically moot. Observing that the court could “decide a moot case if it involves a matter of continuing and substantial public interest,” the court

stated a test for making such a determination:

In determining whether an issue involves a substantial public interest, we consider the public or private nature of the question presented, the need for an authoritative determination that will provide future guidance to public officers, and the likelihood the question will recur.

Id., at 432-33 (citing *Dunner v. McLaughlin*, 100 Wn.2d 832, 838, 676 P.2d 444 (1984) (holding that Washington's civil commitment statutory scheme is a matter of substantial public interest). The *M.B.* court went on to hold that issues involving Washington's juvenile contempt statutes, which arise daily in juvenile courts across the state, are a matter of substantial public interest. In *Josephinium Assocs. v. Kahli*, 111 Wn. App. 617, 622, 45 P.3d 627 (2002), Division One held that the issue of whether the tenant's asserted defense of disability discrimination was a cognizable defense was a matter of "continuing and substantial public interest." In *In re Marriage of Horner*, 151 Wn.2d 884, 93 P.3d 124 (2004), this Court, sitting *en banc*, held that the issue of what a trial court must do in a child relocation case with respect to the child relocation factors is an issue of substantial public interest.

All of the cases cited above that address the issue of "substantial public interest" use the term "public interest" as it is defined in *Black's Law Dictionary, supra, i.e.*, "public interest" involves the "general welfare of the

public that warrants recognition and protection,” or is “[s]omething in which the public as a whole has a stake; . . .” KCU, however, fails to suggest how the Court of Appeals’ construction of RCW 62A.5-101, *et seq.*, could conceivably affect the “general welfare of the public,” as opposed to the interests of the three parties to a letter of credit whose relationship is addressed by Article 5 of the UCC. Nor does KCU explain how the citizens of the State of Washington “as a whole” have a stake in the outcome of the commercial dispute involved in this lawsuit.

Instead, KCU posits that this is a case of first impression in Washington. This is a true statement; in fact the Court of Appeals’ decision appears to be the only reported decision of a Washington appellate court that addresses Article 5 of the UCC since the Legislature enacted new legislation governing letters of credit under Article 5 in 1997. *See LAWS OF 1997, Ch 56, §§ 1-18.* The paucity of litigation under Article 5 suggests that disputes involving Article 5 rarely arise in this state. Not only is there a dearth of interest in Washington in litigating matters involving Article 5, the *Krause* case is the only case from any jurisdiction in the entire U.S. that was cited by KCU to the trial court that remotely addresses the issues involved in this

case.³ The public interest is not subverted if the decision of the Court of Appeals, involving as it does a matter of private interest between the parties, is allowed to stand without review.

VI.

CONCLUSION

The Petitioner has failed to satisfy the requirements of RAP 13.4(b). Mr. Alhadeff respectfully requests that the Court deny KCU's petition for review.

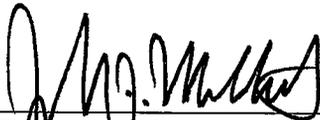
RESPECTFULLY submitted this 30th day of July, 2008.

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 FOR

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³*Krause v. Stroh Brewing Co., supra*, whose holding the Court of Appeals rejected, is discussed in detail in Appellant's Reply Brief, pp. 11-18.

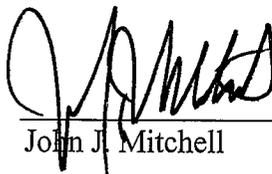
CERTIFICATE OF SERVICE

JOHN J. MITCHELL declares as follows:

On July 30, 2008, I deposited into the U.S. Mail, with postage prepaid, a copy of the Answer To Petition For Review in this matter addressed to the attorney for Petitioner as follows:

Frank R. Siderius, Esq.
Siderius Lonergan & Martin LLP
500 Union St., Ste. 847
Seattle, WA 98101

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct. Executed on Bainbridge Island, Washington on July 30, 2008.



John J. Mitchell