No. 47224-4-II

COURT OF APPEALS
DIVISION II
OF THE STATE OF WASHINGTON

SHASTA APARTMENTS, LLC, CHARLES R. JOHNSON, II AND ELIZABETH A. JOHNSON,

Appellants,

v.

UMPQUA BANK,

Respondent.

APPELLANTS' REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

State Cases

Federal Cases

State Statutes

Superior Court Rules

COME NOW Appellants, Shasta Apartments, LLC ("Shasta") and Charles Johnson, II and Elizabeth A. Johnson, and their marital community, (collectively, the "Johnsons"), and hereby submit Appellants' Reply Brief.

I. INTRODUCTION

In the Brief of Respondent, Umpqua Bank ("Umpqua") makes two principal arguments. First, Umpqua argues that it conducted a RCW 61.12 judicial foreclosure or something sufficiently akin to one and, therefore, it ought to have the same rights post-foreclosure as if an RCW 61.12 judicial foreclosure had actually occurred. Second, Umpqua argues that it preserved all its possible remedies through its loan documents and, as a corollary, Shasta and the Johnsons waived any statutory and common law defenses they might have to any form of collection action based on such documents. Umpqua's first argument must fail because an RCW 61.12 judicial foreclosure was not conducted and Washington's Receivership Act (RCW 7.60) provides no right to seek a deficiency judgment, unlike Washington's Mortgage Act (RCW 61.12). Likewise, Umpqua's second argument also fails because the statutory foreclosure framework does not authorize the contractual expansion of a lender's post-foreclosure remedies and the so-called "waivers" that purport to do so are unenforceable.

II. ARGUMENT

A. Umpqua Has Come Forward with No Statutory or Common Law Authority Establishing It Has a Legal Right to a Deficiency after a Receivership Act Foreclosure.

Because the right to a deficiency judgment is a creature of statute, Umpqua bears the burden in this case of establishing that it has a positive legal right to a deficiency in the first instance. Umpqua has utterly failed to meet this burden as it has not come forward with any definitive authority establishing that it had the right to a deficiency following the receiver's sale of the Property.[1]

Umpqua relies upon unsupported statements of the "law" and citations to cases that do not support its position, even relying upon the "laws of arithmetic." Specifically, Umpqua articulates its position as follows:

> [A] deficiency is nothing more than the remaining amount owed after the sale proceeds are applied to the loan balance, *i.e.*, the "deficit," and not specific to either a judicial or nonjudicial foreclosure. Accordingly, the Court's ability to award a deficiency Judgment [sic] exists independently of foreclosure statutes.
>
> * * *
>
> First, the very character of the disputed award – a deficit – establishes Umpqua was granted neither double redress nor more than its entitled amount. A "deficiency" judgment is simply the difference between the outstanding loan balance and the lesser collateral proceeds received, plus costs allowed by contract. *First-Citizens Bank & Trust Co. v.*

[1] Unless otherwise indicated, capitalized terms herein have the meanings provided in Appellants' Opening Brief.

> *Reikow*, 177 Wn. App. 787, 793-96, 313 P.3d 1208 (2013); *also see*, *Washington Fed. v. Gentry*, 179 Wn. App. 470, 475-76, 319 P.3d 823, *aff'd., Washington Fed. v. Harvey*, 182 Wn.2d 335, 340 P.3d 846 (Jan. 8, 2015). Consequently, by definition and the laws of arithmetic the Judgement [sic] did not award Umpqua more than it was entitled to collect.

(Brief of Respondent, pp. 2, 13-14).

Strikingly, Umpqua cites no statute for the proposition that it had the right to a deficiency following the receiver's sale of the Property. One would assume then that the cases to which Umpqua cites, i.e. Reikow and Gentry, would establish its common law right to a deficiency. However, both Reikow and Gentry are nonjudicial post-foreclosure cases (i.e. RCW 61.24 cases) and neither case establishes a post-foreclosure common law right to a deficiency as Umpqua argues.

As provided in Shasta and the Johnsons' Opening Brief, the right to a deficiency judgment in Washington is purely statutory. *See* Washington Mut. Sav. Bank v. United States, 115 Wn.2d 52, 57, 793 P.2d 969 (1990) *clarified on denial of reconsideration*, 800 P.2d 1124 (Wash. 1990); *see also* Bank of Hemet v. United States, 643 F.2d 661, 667 (9th Cir. 1981) and Bradley Engineering and Machinery Co. v. Muzzey, 54 Wn. 227, 229, 103 P. 37 (1909); *see also* RCW 61.12.070-080. Umpqua has come forward with no authority to refute the authority provided in this paragraph.

Umpqua makes several additional, related arguments. One argument it advances is that the election of remedies doctrine does not prohibit Umpqua from seeking a deficiency judgment here. Shasta and the Johnsons have not argued, and did not argue below, this doctrine. Rather, Shasta and the Johnsons simply rely upon the application of Washington's comprehensive foreclosure scheme. Again, the Receivership Act does not provide for a post-sale right to a deficiency and Umpqua did not conduct a judicial (RCW 61.12) or nonjudicial (RCW 61.24) foreclosure, either of which would have permitted pursuit of a deficiency if their provisions were followed.

Umpqua also argues that the sale of the Property that occurred here was not a foreclosure sale because a receivership is merely ancillary to some other main cause of action and it is not an independent remedy. Umpqua cites to cases decided in 1917 and 1920 for this proposition. Umpqua's argument fails to account for the fact that the legislature completely replaced the prior receivership statutes and adopted the present Receivership Act in 2004, consequently authority pre-dating the revisions to the Receivership Act are of little to no guidance in interpreting the present statute. Since 2004, a receivership may be sought as an independent remedy or ancillary to other remedies. In that regard, RCW 7.60.025(1)(a) provides that "A receiver may be appointed under this

subsection (1)(a) whether or not the application for appointment of a receiver is combined with, or is ancillary to, an action seeking a money judgment or other relief . . . ." This is what occurred in this case. In its Petition for Appointment of General Receiver for Real Property, RCW 7.60.025, and for Judicial Foreclosure ("Petition"), as indicated by the title of such petition, Umpqua sought and obtained the appointment of a general receiver to liquidate all of the assets of Shasta, including the Property, and sell the Property "free and clear of liens and of all rights of redemption." (CP 6-9, 98-104).[2] Pursuant to CR 8(a), Umpqua pleaded for relief in the alternative and also sought in the Petition the right to foreclose the Property judicially under RCW 61.12, which remedy Umpqua ultimately did not pursue. (CP 6; 9). A Receivership Act sale of real estate, as was obtained here, can be an independent remedy, and it amounts to another avenue to foreclose real estate in Washington but with certain compromises, i.e. loss of the right to a deficiency judgment.

Another related argument Umpqua makes is that because it sued for a judicial foreclosure (i.e. plead for an RCW 61.12 judicial

[2] Umpqua makes the claim in its Brief of Respondent that "Shasta and the Johnsons cite to no evidence and make no arguments that Umpqua itself requested the sale be made without redemption rights, or waived any rights under the Loan documents by accepting proceeds of the Court-ordered sale." (Brief of Respondent at p. 30). In its Petition and in the Order Appointing General Receiver which Umpqua prepared and presented to the trial court, Umpqua sought the sale of the Property "free and clear of liens and of all rights of redemption." (CP 101, 238). Umpqua's claims to the contrary are simply untrue and a futile attempt to distance itself from the remedy it crafted.

foreclosure) in its Petition in addition to a Receivership Act sale and because a Receivership Act sale is a judicial sale, Umpqua is entitled to seek a deficiency. In other words, because of a court's involvement in an RCW 61.12 sale and an RCW 7.60 sale, the sale here should be treated the same as an RCW 61.12 judicial foreclosure. Umpqua goes so far to say that:

> Appellants articulate no reason that the deficit remaining after crediting proceeds from a court-ordered and court-approved Receiver's sale should be treated any differently from the deficit remaining after a court-ordered and court-approved foreclosure sale. There is no rational basis to conclude Umpqua is not entitled to Judgment for its post-Receiver's sale deficit, but would be entitled to Judgment for its post-foreclosure sale deficit under RCW 61.12.070.

(Brief of Respondent at p. 24). The linchpin of Washington's foreclosure system – the right of redemption -- is the "rational" basis for distinguishing between a judicial foreclosure under RCW 61.12 where the right of redemption is retained, and a judicial sale under RCW 7.60 that eliminates any right to redemption. This dichotomy is fundamental to Washington's foreclosure system. Again, Umpqua has come forward with no authority that it is entitled to seek a deficiency after a Receivership Act foreclosure sale and its attempt to characterize such sale as substantially equivalent to an RCW 61.12 judicial foreclosure should be rejected as unsupported by the law.

B. Washington's Foreclosure Framework Does Not Authorize the Contractual Expansion of a Lender's Post-Foreclosure Remedies and any Purported Contractual Waivers by Borrowers, Grantors, or Guarantors Are Unenforceable.

In the Brief of Respondent, Umpqua attempts to re-characterize a lender's legislatively limited post-foreclosure deficiency rights as debtor or guarantor rights or defenses that can be expanded in its favor or waived like other common law rights or defenses. But what Umpqua labels as a "waiver" of debtor and/or guarantor rights is in reality an attempt to contractually expand its legislatively created remedies. Lenders are without legal authorization to do so.

That said, the Deed of Trust Act does give broad authorization to a lender to contractually waive its limited right to post-foreclosure remedies. In that regard, RCW 61.24.100(9) provides as follows: "Any contract, note, deed of trust, or guaranty may, by its express language, prohibit the recovery of any portion or all of a deficiency after the property encumbered by the deed of trust securing a commercial loan is sold at a trustee's sale."

By contrast, the Deed of Trust Act's authorization to contractually modify protections accorded guarantors is extremely limited. Specifically, RCW 61.24.100(4) allows contractual modification of the one-year statute of limitations to file a deficiency suit; provided the contract is entered after

the requisite notice of foreclosure is given and is signed by the liable party; RCW 61.24.100(7) authorizes guarantors to waive the Deed of Trust Act prohibition against deficiencies, but only after a beneficiary receives title to the property by a deed-in-lieu of foreclosure and the agreement is part of the deed-in-lieu transaction; and RCW 61.24.100(11) authorizes guarantors to waive any right they might have to reimbursement from the borrower.

The narrow and limited authorizations in subsections (4), (7), (9) and (11) are the only circumstances in which the legislature allows contractual modification of deed of trust limitations on post-foreclosure deficiency claims. The Deed of Trust Act does not authorize contractual modification of RCW 61.24.100(10). The doctrine of *Expressio unius est exclusio alterius* applies. Having expressly authorized contractual modification of RCW 61.24.100's limits, in certain specified instances, contractual modification ("waivers") of other limits are deemed deliberately excluded. Landmark Dev., Inc. v. City of Roy, 138 Wn.2d 561, 571, 980 P.2d 1234 (1999). This is particularly true in light of the Supreme Court of Washington's recent decisions rejecting lenders' attempts to contractually avoid Deed of Trust Act mandates, stating "we will not allow waiver of statutory protections lightly." *See* Bain v. Metro. Mortg. Grp., Inc., 175 Wn.2d 83, 107-08, 285 P.3d 34 (2012); Schroeder

v. Excelsior Mgmt. Grp., LLC, 177 Wn.2d 94, 106-07, 297 P.3d 677 (2013).

In Bain, the Court held that the Deed of Trust Act limited the power of nonjudicial foreclosure to a trustee appointed by a beneficiary that, as required by the Act, holds the promissory note secured. Although the designated beneficiary in Bain did not hold the note, the lender argued it could nonetheless foreclose nonjudicially because the parties contractually agreed to accept the party designated as beneficiary. The Court rejected that argument, holding that the Deed of Trust Act could not be contractually altered. Bain, 175 Wn.2d at 108. The Bain court analogized the Deed of Trust Act to Washington's former Arbitration Act (the "WAA"), RCW 7.04, as construed in Godfrey v. Hartford Cas. Ins. Co., 142 Wn.2d 885, 16 P.3d 617 (2001). The WAA did not authorize a trial *de novo* following an arbitration, but neither did it contain an express prohibition against contractual modification of the Act's provisions. Nonetheless, in rejecting a contractual *de novo* trial provision, the Godfrey court held that, once parties elect to invoke arbitration under the WAA, "efforts to alter fundamental provisions of the Act by agreement are inoperative," noting that "arbitration in Washington is exclusively statutory." Id. at 893, 896. The Bain court relied on its analysis in

Godfrey to conclude that contracts purporting to modify the Deed of Trust Act are also inoperative:

> This is not the first time that a party has argued that we should give effect to its contractual modification of a statute. In *Godfrey*, Hartford ... attempted to pick and choose what portions of the [WAA] it and its insured would use to settle disputes. The court noted that parties were free to decide whether to arbitrate, and what issues to submit to arbitration, but 'once an issue is submitted to arbitration, [the WAA] applies.' By submitting to arbitration, '**they have activated the entire chapter and the policy embodied therein, not just the parts useful to them**.' The legislature has set forth in great detail how nonjudicial foreclosures may proceed. We find no indication the legislature intended to allow the parties to vary these procedures by contract. We will not allow waiver of statutory protections lightly.

Bain, 175 Wn.2d at 107-08 (emphasis added, citations omitted).

The analysis in Bain (and Godfrey) applies here. Like arbitration, foreclosure in Washington is exclusively statutory, whether RCW 61.12, RCW 61.24, or RCW 7.60 is utilized by the lender to sell the property at issue. Once Umpqua elected to sell the Property pursuant to the Receivership Act, it submitted to the entire Receivership Act and Washington's foreclosure laws generally, not just the parts useful to Umpqua. Having chosen to proceed under the Receivership Act, Umpqua cannot via contract jettison Washington's statutory limits on post-foreclosure deficiency judgments.

The Washington Supreme Court confirmed that Deed of Trust Act mandates may not be contractually modified in Schroeder, 177 Wn.2d 94. In Schroeder, the borrower had recited in the deed of trust that he "knowingly waives his right, pursuant to RCW 61.24.030(2) to judicial foreclosure on the subject property on the grounds it is used for agricultural purposes." Schroeder, 177 Wn.2d at 100. The lender argued that this recitation amounted to the borrower's waiver of the Deed of Trust Act's statutory prohibition on nonjudicial foreclosures of agricultural land. Citing Bain, the Court rejected the lender's argument, holding that the lender could not contract away the Deed of Trust Act's statutory prohibitions. Washington's foreclosure statutes constitute a carefully balanced statutory scheme and all of the statutes comprising such scheme are necessary to implement its public policy. RCW 61.24.100, for example, is not an isolated statutory provision creating only borrower and guarantor "rights and privileges" that may easily be waived like a common law right. It is part of a statutory framework that expressly limits post-foreclosure remedies upon all lenders, including Umpqua, that voluntarily choose to reap the benefits of Washington's foreclosure scheme.

Shasta and the Johnsons' position is further supported by the recent Division II decision in First-Citizens Bank & Trust Co. v. Reikow, which interpreted waivers in guaranties identical to those presented here. 177

Wn. App. 787, 313 P.3d 1208 (2013). The Reikow court held that such waivers do not entitle the bank to a larger deficiency judgment than the Deed of Trust Act allows. Id. at 796-97. Reikow is in accord with Bain and Schroeder, and is directly applicable to this case.

The clear policy of the Deed of Trust Act regarding deficiencies is reflected in the first sentence of RCW 61.24.100: "Except to the extent permitted in this section for deeds of trust securing commercial loans, a deficiency judgment shall not be obtained on obligations secured by a deed of trust against any borrower, grantor, or guarantor after a trustee's sale under a deed of trust." The policy is that post-foreclosure deficiencies are prohibited unless expressly authorized by the Deed of Trust Act. Umpqua's attempt to contractually eliminate and circumvent express Deed of Trust Act limits on post-foreclosure deficiencies in no way furthers the Act's policies.

Finally, the Deed of Trust Act's protections are not limited to homeowners and potentially unsophisticated borrowers. It extends to commercial borrowers as well, limiting its authorization for any deficiency judgment to cases where a commercial borrower causes a deficiency by waste or wrongful retention of rents. RCW 61.24.100(3)(a). Similarly, the Deed of Trust Act limits deficiencies against commercial guarantors. A lender's right to seek a deficiency against a guarantor is limited to: 1)

actions against guarantors that received proper notice (RCW 61.24.100(3)(c)); 2) actions commenced within one year of the trustee's sale (RCW 61.24.100(4)); 3) actions against grantor-guarantors who commit waste or wrongfully retain rents (RCW 61.24.100(6)); and 4) actions on guaranties which guarantee the foreclosed deed of trust (RCW 61.24.100(10)).

Even where legislatively authorized, a lender's right of recovery against a commercial guarantor is expressly limited to the difference between the guaranteed debt and the fair value of the foreclosed property at the time of trustee's sale, regardless of the actual sale price. RCW 61.24.100(5).

These provisions, together with the rest of the Deed of Trust Act and Washington's other foreclosure statutes, collectively set forth the public policy of foreclosure in Washington. That policy is advanced by enforcing the Deed of Trust Act and Washington's other foreclosure statutes as written, rather than allowing lenders to contractually modify such statutes to expand their legislatively limited post-foreclosure remedies as Umpqua attempted here.

III. REQUEST FOR ATTORNEY FEES AND COSTS

Pursuant to RAP 18.1 and on the basis previously provided in their Opening Brief, Shasta and the Johnsons request the recovery of their

attorney fees and costs should they prevail on appeal in accord with the parties' contracts.

IV. CONCLUSION

Shasta and the Johnsons respectfully request this Court to: (1) reverse the trial court's grant of Umpqua's Motion for Summary Judgment against Shasta, Default Judgment against the Johnsons, and the award of judgment in favor of Umpqua against Shasta and the Johnsons; (2) reverse and vacate the trial court's grant of Final Judgment in favor of Umpqua against Shasta and the Johnsons; (3) grant Shasta and the Johnsons' Motion for Summary Judgment against Umpqua; and 4) grant Shasta and the Johnsons' prevailing party attorney fees and costs incurred both on appeal and in the trial court and reverse the award of such fees and costs to Umpqua below.

DATED this 26th day of October 2015.

MCGAVICK GRAVES, P.S.

By: _____

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DECLARATION OF SERVICE

The undersigned declares under the penalty of perjury under the laws of the State of Washington that I am a citizen of the United States, a resident of the State of Washington, over the age of eighteen years, not a party or interested in the above-entitled action, and competent to be a witness herein.

On the date given below, per the electronic service agreement of the parties, I caused to be served via E-Mail and further via ABC Legal Messengers, a copy of the foregoing Appellants' Reply Brief to:

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Signed at Tacoma, Washington this 26th day of October 2015.

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