

No. 67370-0-I

DIVISION I, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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THE BANK OF NEW YORK MELLON, FKA THE BANK OF NEW  
YORK AS SUCCESSOR IN INTEREST TO JPMORGAN CHASE  
BANK, NA AS TRUSTEE FOR STRUCTURED ASSET MORTGAGE  
INVESTMENTS II INC. BEAR STEARNS ALT-A TRUST 2005-9,  
MORTGAGE PASS-THROUGH CERTIFICATES, SERIES 2005-9

Appellant

v.

SCOTTY'S GENERAL CONSTRUCTION, INC., A WASHINGTON  
CORPORATION

Respondent

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ON APPEAL FROM KING COUNTY SUPERIOR COURT  
(HON. HOLLIS HILL)

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REPLY BRIEF OF APPELLANT

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Ronald E. Beard, WSBA No. 24014  
[beardr@lanepowell.com](mailto:beardr@lanepowell.com)  
David C. Spellman, WSBA No. 15884  
[spellmand@lanepowell.com](mailto:spellmand@lanepowell.com)  
Carson R. Cooper, WSBA No. 44252  
[cooperc@lanepowell.com](mailto:cooperc@lanepowell.com)  
LANE POWELL PC  
Attorneys for Appellant  
The Bank of New York Mellon,

2016 MAR 23 PM 4:24  
COURT OF APPEALS  
STATE OF WASHINGTON  
FILED

LANE POWELL PC  
1420 Fifth Avenue, Suite 4100  
Seattle, Washington 98101-2338  
Telephone: 206.223.7000  
Facsimile: 206.223.7107

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## I. INTRODUCTION

The trial court committed clear error when it granted the CR 12(b)(6) dismissal of The Bank of New York Mellon's (BNY Mellon) complaint. Such a dismissal "should be granted 'sparingly and with care,' and only in the unusual case in which the plaintiff's allegations show on the face of the complaint an insuperable bar to relief."<sup>1</sup> The record fails to establish the necessary "insuperable bar" to recovery on the complaint.<sup>2</sup>

The complaint seeks a declaratory judgment ruling that BNY Mellon's mortgage has priority of record over a construction lien foreclosed by respondent Scotty's General Construction, Inc. (Scotty's) in an earlier suit.<sup>3</sup> BNY Mellon was not a party in the earlier suit. BNY Mellon, "not having been a party to [respondent's] lien foreclosure proceedings, cannot be bound by the lien judgment, and have a prior mortgage subverted to [respondent's] subsequent lien judgment." *Gile Inv. Co. v. Fisher*, 104 Wash. 613, 618, 177 P. 701 (1919).

The amendments to the construction lien statute's joinder provision do not alter that well-settled rule. The statute's plain terms and the rules of construction dispel Scotty's legerdemain that conjures an optional joinder provision into a mandatory joinder provision with super-priority powers.

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<sup>1</sup> *San Juan Cnty. v. No New Gas Tax*, 160 Wn.2d 141, 164, 157 P.3d 831 (2007).

<sup>2</sup> *Id.*

<sup>3</sup> Compl. at 4:13-14, CP 4.

The plaintiff-friendly standard of review requires Scotty's to establish that "it appears beyond reasonable doubt that the plaintiff can prove no set of facts, consistent with the complaint, which would entitle the plaintiff to relief."<sup>4</sup> Yet, Scotty's complains "BNY Mellon raises speculative facts ... in its Opening" Brief.<sup>5</sup> Those speculative facts are an essential part of the standard of review, where "any hypothetical situation conceivably raised by the complaint defeats the motion to dismiss if it is legally sufficient to support the complaint."<sup>6</sup> The question is "whether any fact which would support a valid claim can be conceived."<sup>7</sup>

Scotty's initially wishes away Mortgage Electronic Registration Systems Inc.'s (MERS) status as the mortgage's grantee of record and then proceeds to make up three facts. Scotty's contends that it had the prerogative to name as defendant Centralbanc (instead of MERS) and then in turn "[a]fter Scotty's commenced its lawsuit Centralbanc assigned its Deed of Trust to BNY Mellon," so BNY Mellon is bound by the prior judgment against Centralbanc.<sup>8</sup> But the complaint does not allege that: (1) "Centralbanc assigned its Deed of Trust to BNY Mellon;" or (2) Centralbanc had the mortgage when Scotty's filed suit; or (3) BNY Mellon

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<sup>4</sup> *Bravo v. The Dolsen Cos.*, 125 Wn.2d 745, 750, 888 P.2d 147 (1995).

<sup>5</sup> Br. of Resp't at 5.

<sup>6</sup> *Bravo v. The Dolsen Cos.*, 125 Wn.2d at 750.

<sup>7</sup> *Id.*

<sup>8</sup> Br. of Resp't at 1.

acquired the mortgage *only after* the suit was filed.<sup>9</sup> These facts are pure fiction.

While fictional facts may be presented in support of BNY Mellon's complaint, they may not be used to dispose of the case. BNY Mellon was entitled to an opportunity to prove the mortgage retained its priority over the junior lien. BNY Mellon has the mortgage note. The mortgage follows the note. An unrecorded assignment of a mortgage does not lose its priority. It takes the priority of the recorded mortgage. End of story. The hypothetical situation (and reality) is that Centralbanc indorsed and transferred the mortgage note in June 2005.

Even if the subsequent assignment of the mortgage by MERS was a "nullity" (which would require the adoption of unprecedented new law),<sup>10</sup> BNY Mellon has the right to enforce the mortgage. It has the mortgage note. In summary, the dismissal violates 12(b)(6)'s stringent requirements. It also contravenes the three established rules set forth in BNY Mellon's opening brief, as explained below.

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<sup>9</sup> *Id.*

<sup>10</sup> Compare CP 440:9-20 & n.3; CP 47:1-13 with *Myers v. Mortg. Elect. Registration Sys, Inc.*, 2012 U.S. Dist. LEXIS 30891, \*9-\*11 (W.D. Wash. Feb. 24, 2012) ("Courts routinely reject these claims" that MERS' involvement taints foreclosure process and violates the deed of trust act). One of Scotty's claims for the invalidity of the MERS transfer of the mortgage was on the basis of an alleged conflict of interest by the trustee for the deed of trust. CP 57:17-60:26. Scotty's has wisely abandoned that claim.

## II. ARGUMENT

### A. **The first dispositive rule: a foreclosure decree cannot bind a person with a recorded interest and who was not a party.**<sup>11</sup>

“Actions to foreclose construction liens are ‘quasi in rem proceedings, i.e. they determine the interests of certain defendants in a thing in contrast to a proceeding in rem, which determines the interests of all persons in the thing.’”<sup>12</sup> “Consequently, joinder of any person having an interest is essential in that, if not joined, his interest will not be affected by the foreclosure.”<sup>13</sup> Here, neither BNY Mellon nor its agent (MERS) was joined in the prior suit. Therefore, BNY Mellon’s mortgage was not affected by the foreclosure.

#### 1. The rule is firmly established.

Scotty’s mistakenly asserts the rule “is not supported by Washington law.”<sup>14</sup> The rule is firmly rooted here and broadly implanted elsewhere. Summarizing Washington law, Professor Stoebuck states the very same rule when identifying the necessary parties for the judicial foreclosure of a

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<sup>11</sup> *Diversified Wood Recycling, Inc. v. Johnson*, 161 Wn. App. 859, 889, 877, 251 P.3d 293, 308 (*Diversified Wood I*), review denied, 172 Wn.2d 1025, 268 P.3d 224 (2011); *Diversified Wood Recycling, Inc. v. Johnson*, 161 Wn. App. 891, 902, 251 P.2d 908 (*Diversified Wood II*), review denied, 172 Wn.2d 1025, 268 P.3d 224 (2011).

<sup>12</sup> *Diversified Wood II*, 161 Wn. App. at 902 (quoting *Hasek v. Terrene Excavators, Inc.*, 44 Wn. App. 554, 557, 723 P.2d 1153 (1986)).

<sup>13</sup> *Diversified Wood II*, 161 Wn. at 903 (quoting *Valentine v. Portland Timber & Land Holding Co.*, 15 Wn. App. 124, 128, 547 P.2d 912, review denied, 87 Wn.2d 1015, (1976)). “Thus, if the owner or anyone else with a recorded interest in the property is not made a party, the consequence is that his or her interest will not be foreclosed or affected.” *Diversified Wood I*, 161 Wn. App. at 889 (quoting 27 Marjorie Dick Rombauer, *Wash. Practice: Creditor, Remedies-Debtors’ Relief* § 4.71 at 369 (1998)).

<sup>14</sup> Resp’t’s Br. at 13.

mortgage: “Only those parties named and served with the summons and complaint will be affected by the outcome of a foreclosure action.”<sup>15</sup> Professor Rombauer, discussing the joinder in a construction lien foreclosure, states the very same rule.<sup>16</sup> The rule is grounded in case law spanning over a century.<sup>17</sup> Its broad adoption is reflected in the first sentence of RESTATEMENT (THIRD) OF THE LAW OF PROPERTY: MORTGAGES § 7.1 (1997): “A valid foreclosure of a mortgage terminates all interests in the foreclosed real estate who are junior to the mortgage being foreclosed and whose holders are properly joined or notified under applicable law.” Section 7.1’s second sentence states: “Foreclosure does not terminate interests in the foreclosed real estate that are senior to the mortgage being held.” *Id.* That is the second dispositive rule relied upon by BNY Mellon. *See infra* at 9.

The legal effect of the failure to join the mortgagee is the prior suit has no legal effect whatsoever on the mortgage.<sup>18</sup>

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<sup>15</sup> 18 *Wash. Practice: Real Estate Transactions* § 19.2 at 374.

<sup>16</sup> “If a person with a recorded interest is not made a party, his or her interest will not be foreclosed or affected.” 27 *Wash. Practice, Creditors’ Remedies-Debtors Relief*, § 4.71

<sup>17</sup> *MB Constr. Co. v. O’Brien Comm. Center Assocs.*, 63 Wn. App. 151, 158, 816 P.2d 1274 (1991); *Davis v. Bartz*, 65 Wash. 395, 118 P. 334 (1911).

<sup>18</sup> CP 296:11-13 (arguing the failure to join MERS in the prior suit); CP 302:16-30:6 (same and relying upon RCW 60.04.171’s requirement that any person with a recorded interest “shall not be foreclosed or affected unless they are joined as a party.”); CP 306:16-17 (“The facts of this case will lead a reasonable trier of fact to find the defendant failed to properly join MERS as a party to the mechanic’s lien foreclosure action ...”).

2. The rule's exception for an unrecorded encumbrance does not apply.

Scotty's relies upon an exception to the rule requiring joinder of parties in foreclosures. The exception is "a party who obtains an interest in property after commencement of a lien foreclosure lawsuit is bound by the outcome of that suit, even if not joined as a party." Resp't's Br. at 11 (underline added) (citing *McLaughlin v. Zarbell*, 29 Wn.2d 817, 190 P.2d 114 (1948)). This is the lis pendens doctrine that applies to unrecorded junior lienors: "the correct rule is that the claimant under an *unrecorded* instrument is bound by the judgment of foreclosure to the same extent and in the same manner as if he were a party to the action, where the lis pendens is filed." *Payson v. Jacobs*, 38 Wash. 203, 208, 80 P. 429 (1905) (italics added).<sup>19</sup> In contrast, where there is a *recorded* junior interest that is omitted from a foreclosure, the remedy is a re-foreclosure.<sup>20</sup>

Scotty's mistakenly applies a rule for an unrecorded and junior encumbrance to a recorded and senior encumbrance. Scotty's had constructive notice of the superior mortgage securing a mortgage note.

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<sup>19</sup> "Moreover, junior interests that arise after the commencement of the foreclosure are treated as parties to the action by virtue of the lis pendens doctrine." RESTATEMENT (THIRD) OF PROPERTY: MORTGAGES § 7.1, cmt. b. See George E. Osborne *Handbook on the Law of Mortgages* § 322 at 673 (2d ed. 1970) ("Where the subordinate interest is acquired during the pendency of the foreclosure action it is uniformly held that the foreclosure sale will cut it off just as effectively as though its owner had been made a party. ... by virtue of the common law doctrine of lis pendens ...").

<sup>20</sup> *U.S. Bank v Hursey*, 116 Wn.2d 522, 526, 72 P.2d 245 (1991) ("a decree of foreclosure does not affect the interest of a junior who was not joined in the foreclosure action."); Osborne, *Law of Mortgages* § 322 at 672 (2d ed. 1970) (similar rule).

From that constructive notice are the legal consequences requiring the reversal of the 12(b)(6) dismissal of BNY Mellon's complaint.

The legal consequences of constructive notice are the dispositive principle in *McLaughlin*. There, the party seeking to nullify a foreclosure decree was the purchaser of an automobile already encumbered with a recorded mechanics' lien.<sup>21</sup> The court observed that while the purchaser of the automobile took with constructive notice of the mechanic's lien, the lienholder had no notice of the purchaser's interest "until after entry of the decree of foreclosure of the lien."<sup>22</sup> Scotty's position is that of the purchaser of the automobile already encumbered by the lien – only worse. Three mortgages already encumbered the property.

The *McLaughlin* court ruled: "one who purchases the property subsequent to commencement of the suit is not a necessary party in the foreclosure suit."<sup>23</sup> "The rule is ... that persons who acquire interest, by conveyance or encumbrance, after the foreclosure suit is instituted, are not necessary parties, but are bound by the decree in the foreclosure action."<sup>24</sup> That rule does not apply here where the recorded interest was acquired in

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<sup>21</sup> 29 Wn.2d at 817.

<sup>22</sup> *Id.* at 820.

<sup>23</sup> *Id.* at 819-20.

<sup>24</sup> *Id.* at 820 (underlined added) (quoting *Whitney v. Higgins*, 10 Cal. 547, 550-51, 554 (1858); *id.* (also quoting from *Story's Equity Pleadings* § 194).

the real property years before the foreclosure suit was instituted. There was not a “new incumbrance[], created pendente lite.”<sup>25</sup>

The priority of the recorded senior mortgage over the junior construction lien distinguishes this case from *McLaughlin* and the four out-of-state decisions cited in *McLaughlin*.<sup>26</sup>

Applying the same public policy that a recorded interest affords sufficient constructive notice, this court has declined to impose a requirement mandating that construction lien claimants must record lis pendens in conjunction with their foreclosure suits – concluding the recorded liens were sufficient notice.<sup>27</sup> The same policies demonstrate that the recorded mortgage in this case was sufficient notice to Scotty’s of the junior status of its lien, unless one of statutory exception to priority applied. Yet, the assertion of any one of those exceptions was conspicuously absent from Scotty’s pleadings in the earlier case. As a result, the trial court has granted Scotty’s a windfall – the forfeiture of the mortgage’s priority.

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<sup>25</sup> 29 Wn.2d at 820 (quoting *Story’s Equity Pleadings* § 194).

<sup>26</sup> 29 Wn.2d at 820; *Whitney v. Higgins*, 10 Cal. 547, 550-51, 554 (1858) (ruling mortgagees had right to redemption just like the mortgagor, when they acquired interest before suit was brought and were not made parties to the suit); *Oglethorpe Sav. & Trust Co. v. Morgan*, 149 Ga. 787, 102 S.E. 528 (1920); *McCauley v. Rogers*, 104 Ill. 578 (1882); *Cornell v. Conine-Eaton Lumber Co.*, 9 Colo. App. 225, 233-24, 47 P. 912 (1897) (lien foreclosure suit joined both beneficiary and trustee of trust deed but not the assignee of the note; assignee of note admitted to having actual knowledge of the suit but failed to intervene and original beneficiary declined to disclaim and disclose the name of the owner of the note). The Washington Supreme Court later declined to follow *Cornell*. *Davis v. Bartz*, 65 Wash. at 400-01, 118 P. 334 (adopting rule that a mortgagee has the same rights as the property owner to be named as a party to a lien foreclosure suit; concluding failure to timely join the mortgagee caused the lien to expire as to the mortgagee).

<sup>27</sup> *John Morgan Constr. Co. v. McDowell*, 62 Wn. App. 79, 82, 813 P.2d 138 (1991).

Consistent with this rule arising from the vested priority granted under the recording statute, a senior encumbrancer has no redemption right - since his or her property cannot be impaired through the foreclosure of a junior encumbrance, subject to the few exceptions identified below. In contrast, the judgment debtor and “[a] creditor having a lien by judgment, decree, deed of trust, or mortgage, on any portion of the property ... **subsequent** in time to that on which the property was sold” have statutory redemption rights permitting them to salvage something. RCW 6.23.010 (bold added).<sup>32</sup>

The general rule preserving a senior mortgage applies; none of the statutory exceptions were pleaded in Scotty’s complaint.<sup>33</sup>

2. The statutory provisions altering priority do not apply.

There are statutory exceptions to the “race notice” rule of priority, but they do not apply here. One exception is when a construction lender violates the obligation to withhold funds after receiving a RCW 60.04.221 stop-notice, then by operation of law “the mortgage ... shall be subordinated to the lien of the potential lien claimant ....”<sup>34</sup> Another exception is a condominium association lien that has “super priority” over

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<sup>32</sup> *Burwell & Morford v. Seattle Plumbing Supply Co.*, 14 Wn.2d 537, 549, 128 P.2d 859 (1942).

<sup>33</sup> CP 31-37.

<sup>34</sup> *Pacific Cont’l Bank v. Soundview LLC*, 2012 WL 9878010, \*4 (Wn. App. Mar. 26, 2012) (construing RCW 60.04.221).

mortgages recorded before the lien arises.<sup>35</sup> Another exception is “the relation back statute, RCW 60.04.061,”<sup>36</sup> which provides that a construction lien relates back to when lienable activities commence, so that a construction lien “shall be prior to any ... mortgage, deed of trust ... which was unrecorded at the time of commencement of” those lienable activities. Since these three exceptions do not apply, Scotty’s resorts to making an untenable interpretation of the construction lien statute’s joinder provision.

3. The construction lien statute’s joinder provision (RCW 60.04.171) does not alter the rules preserving senior encumbrances and restricting joinder to limited purposes.

Scotty’s contends that it complied with the statute’s joinder provision, RCW 60.04.171.<sup>37</sup> But this contention is both inaccurate and begs the dispositive question. The contention is inaccurate since Scotty’s failed to join MERS – the grantee named on the mortgage – and BNY Mellon – the owner of the mortgage note.<sup>38</sup> Further, the assertion of compliance with the statute begs the question of priority. The statute does not alter the first-in-time priority granted under the race-notice recording statute, RCW 65.08.070.

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<sup>35</sup> *Summerhill Village Homeowners Ass’n v. Roughley*, 270 P.3d 639, 641 (Wn. App. Feb. 21, 2012).

<sup>36</sup> *Zervas Group Architects*, 161 Wn. App. at 326; *Estate of Haselwood v. Bremerton Ice Arena*, 166 Wn.2d 489, 500-01, 210 P.3d 308 (2009).

<sup>37</sup> Br. of Resp’t at 9-10.

<sup>38</sup> Br. of Resp’t at 20-22 (arguing no obligation to join MERS in the foreclosure). *Id.* at 23 (asserting recorder’s index is not determinative of a party’s status). *But see* CP 303:1-5 (observing “MERS was listed twice” as grantee and beneficiary); *Koch v. Swanson*, 4 Wn. App. 456, 459, 481 P.2d 915 (1971) (“one searching the index has a right to rely upon what the index and recorded document discloses ...”).

“The general rule is that a prior encumbrancer cannot be made a party to a foreclosure action without his consent.” George E. Osborne, *Handbook of on the Law of Mortgages* § 323 at 673 (2d ed. 1970). The rule is based on the principle that “a senior mortgagee’s interest cannot be affected by the foreclosure of a junior lien.” *Id.* at 674. “The exceptions, in addition to active consent or acquiescence, include joinder to determine the amount of the superior lien, whether priority actually exists, and, under certain circumstances, e.g., when the senior mortgage has matured.” *Id.* at 673-74. The Restatement confirms: “a foreclosing junior lienor may make the holder of liens parties to a judicial foreclosure action *for the limited purpose of determining the amount of those liens.*” § 7.1, cmt. a (emphasis added).

These same principles govern the foreclosure of a construction lien. The amendments to the construction lien statute were a “clarification and simplification of requirements under the prior act” for the perfection of a recorded construction lien through the filing of a foreclosure suit.<sup>39</sup> RCW 60.04.171 “gives the court some latitude in deciding whether and when to allow joinder of other persons who claim a lien or have an interest

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<sup>39</sup> *Diversified Wood I*, 161 Wn. App. at 887 (quoting 27 *Wash. Practice: Creditors’ Remedies – Debtors’ Relief* § 4.71 at 368 n.1). See Brian A. Blum, *Mechanics’ and Construction Liens in Alaska, Oregon, and Washington* § 8.4 at 297 & n.59 (1994) (discussing confusion under the pre-amendment law about whether junior mortgagees were necessary parties and whether prior mortgagees were necessary parties).

in the same property.”<sup>40</sup> The rules of construction dictate that RCW 60.04.171 is presumed to be consistent - not inconsistent - with the related statutes.<sup>41</sup> This gloss reinforces RCW 60.04.171’s plain terms providing construction liens “may be foreclosed and enforced ... in the manner prescribed for judicial foreclosure of a mortgage.” Its plain terms confirm the restriction that a prior “recorded interest ... shall not be foreclosed or affected unless they are joined as a party.” The amendments do not permit a contractor to leap frog ahead, foreclose and eliminate paramount encumbrances, unless the previously discussed exceptions apply.

Scotty’s misconstrues an optional joinder provision to be a mandatory joinder provision with super-priority powers. RCW 60.04.171 primarily facilitates the determination of priority among the construction liens that will be ranked as part of the foreclosure process. RCW 60.04.181 (listing the hierarchy among construction liens). RCW 60.04.171, ¶ 2 is clearly permissive (“he or she may apply ... to be joined ...”). The provision is for the benefit of those making construction lien claims (“[a]nd his or her lien may be foreclosed in the same action.”).<sup>42</sup> This permissive

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<sup>40</sup> *Diversified Wood I*, 161 Wn. App. at 889.

<sup>41</sup> See, e.g., *State v. B.P.M.*, 97 Wn. App. 294, 300, 982 P.2d 1208 (1999) (statutes are read together to give effect to each and harmonize each with the other). RCW 60.04.900 (directing the provisions are “to be liberally construed to provide security for all parties intended to be protected by their provisions”) This direction applies only where there is an ambiguity. *Williams v. Athletic Field, Inc.*, 172 Wn.2d 683, 698, 261 P.3d 109 (2011). RCW 60.04.171’s instruction is unambiguous.

<sup>42</sup> *Id.*

provision is not a mandatory provision involuntarily forfeiting the priority rights of senior encumbrances.<sup>43</sup> Those priority rights were not waived in this case.

4. There was no subordination of the mortgage's priority.

The complaint in the underlying lawsuit did not plead the subordination of the senior mortgage.<sup>44</sup> Therefore, the priority rule applies: “The lien first in time is the lien first in right, unless the holder of the lien first in time voluntarily subordinates it.” Revised Br. of Appellant at 32 (citing *BNC Mortg., Inc. v. Tax Pros, Inc.*<sup>45</sup>).

While not attacking this settled rule, Scotty's observes that the cited decision is no longer good law for its separate holding applying the volunteer rule defense to equitable subrogation.<sup>46</sup> Equitable subrogation arises when a subordinate mortgagee completely pays off the senior mortgage and stands in its shoes.<sup>47</sup> But Scotty's did not pay off the senior mortgage; there was no subrogation. As a junior lien claimant, it was in

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<sup>43</sup> Compare Br. of Resp't at 19-20 (arguing BNY Mellon should have intervened using the joinder provision) with *Byrne v. Ackertlund*, 108 Wn.2d 445, 453-54, 739 P.2d 1138 (1987) (declaratory judgment action is proper to construe ambiguous judgment or decree).

<sup>44</sup> CP 31-37.

<sup>45</sup> 111 Wn. App. 238, 246 & nn.15-16, 46 P.3d 812 (2002). *Id.* at n.15 (for the first-in-time-and-first-right proposition, citing *Homann v. Huber*, 38 Wn.2d 190, 198, 228 P.2d 466 (1951), and other decisions). *Id.* at n.16 (for the subordination proposition, citing *Nat'l Bank of Wash. v. Equity Investors*, 83 Wn.2d 435, 518 P.2d 1072 (1974); *Campanella v. Rainier Nat'l Bank*, 26 Wn. App. 418, 612 P.2d 460, *review denied*, 94 Wn.2d 1017 (1980)).

<sup>46</sup> Br. of Resp't at 15 (citing *Columbia Cmty. Bank v. Newman Park, LLC*, 271 P.3d 300 (Wn. App. 2012) (rejecting the volunteer rule defense to equitable subrogation after *Bank of Am., N.A. v. Prestance Corp.*, 160 Wn.2d 560, 160 P.3d 17 (2007)).

<sup>47</sup> RESTATEMENT (THIRD) OF PROPERTY § 7.6 (1997) (equitable subrogation).

Scotty's own interest to monitor the title records to safeguard against the consequences of its own suit -- possibly triggering a default on the senior encumbrances -- or against the consequences of the property owner's failure to pay those encumbrances.<sup>48</sup> Yet, Scotty's failed to take any action to safeguard itself against such defaults.

There was no subordination declaration by BNY Mellon or MERS. Scotty's argues that BNY Mellon stands in Centralbanc's shoes and is bound by its actions.<sup>49</sup> "A mortgage, by a declaration by its mortgagee, may be made subordinate in priority to another interest ...." RESTATEMENT (THIRD) OF PROPERTY: MORTGAGE § 7.7 (1997) (entitled Subordination). The issue is who was the mortgagee -- the person authorized to enforce the mortgage? When the mortgage is transferred "before the commencement of the action, then the assignee is not regarded as in privity with the assignor so as to be affected by a judgment against the assignor in the subsequent action."<sup>50</sup> BNY Mellon is entitled to its day in court to prove that Centralbanc transferred the mortgage note before the commencement of the prior action.

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<sup>48</sup> Compare Br. of Resp't at 15-16 (arguing no duty to monitor title after filing suit) with 18 *Wash. Practice: Real Estate Transactions* § 19.4 at 375 (describing how a junior foreclosure may trigger a default event under the senior mortgage and curing the default).

<sup>49</sup> Compare Br. of Resp't at 3 (citing declaration, CP 344-45); Br. of Resp't at 14-15; *id.* at n.2 (contending there is no support that Centralbanc lost authority over the mortgage before the filing of the foreclosure suit) with CP 303:7-16 (BNY Mellon arguing: "Centralbanc's disclaimed interest ... did not eliminate MERS' interest or right to be joined" and emphasizing Centralbanc's "declaration was signed *after*" the mortgage had been assigned to BNY Mellon.) (emphasis in original).

<sup>50</sup> *Cf. Br. of Resp't* at 11-12, 17 with *Hackler v. Hackler*, 37 Wn. App. 791, 795, 683 P.2d 214, *review denied*, 102 Wn.2d 1021 (1084); 47 Am. Jur. 2d *Judgments* § 591 at 152-53 (2006) (same); Restatement (Second) of *Judgments* § 44 cmt. f (1982) (same).

Scotty's case also rests on the assertion: "[i]n the foreclosure lawsuit the trial court found that Scotty's lien was superior to the Centralbanc Deed of Trust."<sup>51</sup> Yet, the actual finding was framed in terms of Centralbanc's interest – it was not framed in terms of a "Deed of Trust."<sup>52</sup> Further, the finding is construed through the lens of the rule of strict construction: "The law is well settled that rights of priority under an agreement of subordination extend to and are limited strictly by the express terms and conditions of the agreement."<sup>53</sup> Those express terms do not mention BNY Mellon.

BNY Mellon was entitled to rest on its superior rights. Even if Centralbanc provided Scotty's with false information about the mortgage, Scotty's recourse is against Centralbanc.<sup>54</sup> Yet, the record reflects Scotty's received no false information. Scotty's has been caught overreaching and has caused BNY Mellon to spend considerable time and expense responding to a dismissal motion should never have been brought in the first place.

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<sup>51</sup> Br. of Resp't at 1,183; CP 50:26-51:3 (motion); CP 141:15-19 (Finding 16); CP 142:27-28 (Conclusion 5).

<sup>52</sup> Br. of Resp't at 1; CP 141:15-19 (Finding 16); CP 142:27-28 (Conclusion 5); *compare* CP 118 (second mortgage); CP 344-45 (declaration signed on July 19, 2010) *with* CP 30 (assignment to BNY Mellon recorded on June 29, 2010).

<sup>53</sup> *Ban-Co. Inv. Co. v. Loveless*, 22 Wn. App. 122, 134-35, 587 P.2d 567 (1978) (citation omitted).

<sup>54</sup> *Cf.* Br. of Resp't at 19 (Scotty's contending that BNY Mellon could have sued Centralbanc for the failure to disclose Scotty's suit).

**C. The third dispositive rule: the unrecorded assignment takes the priority of the senior mortgage.<sup>55</sup>**

Scotty's believes the second rule (the priority of record) and the third rule (the priority is not lost, when held by an unrecorded mortgage) "miss the basic premise that BNY Mellon is an assignee ... and therefore only has whatever rights Centralbanc had to assign" and "the lien priority was subject to the outcome of the pending lien foreclosure."<sup>57</sup> But Scotty's own "basic premise" rests on the false factual assumption that "Centralbanc had rights to assign" and on the outlier theory that any transfer of the mortgage was a nullity.<sup>58</sup>

Scotty's asks this Court not to consider the third rule (the unrecorded assignment taking the priority of the senior mortgage), since it was raised on appeal for the first time.<sup>59</sup> Yet, the complaint asserted BNY Mellon's "interest in the property is superior to the Defendant's interest under RCW 60.04.061" (the relation-back statute).<sup>60</sup> Scotty's never challenged that priority, so it is entirely appropriate to consider the third

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<sup>55</sup> *Miller v. Am. Savings Bank & Trust Co.*, 119 Wash. 243, 250, 205 P. 388 (1922) (quoting *Jones on Mortgages* (7th ed.), § 525, p. 828).

<sup>56</sup> Br. of Resp't at 17-18.

<sup>57</sup> Br. of Resp't at 17-18.

<sup>58</sup> Br. of Resp't at 1; CP 440:8-26 & n.3.

<sup>59</sup> Br. of Resp't at 8-9.

<sup>60</sup> CP 3:18-22; CP 2:9-13 (assignee status); *see* CP 306:9-11; CP 298:24-25 (assignee status); CP 303:15-015 (same).

rule whose “basic reasoning” was argued below and which “related to the issues raised before the trial court.”<sup>61</sup>

Scotty’s contends the following arguments are being made for the first time on appeal: Centralbanc was not BNY Mellon’s representative in the foreclosure; BNY Mellon should have been joined; the lack of joinder/notice and denial of due process; and “the King County Recorder’s Index identif[y]ing] MERS as the grantee ....”<sup>62</sup> Yet, these claims or analogous ones were raised and thus preserved for appeal. BNY Mellon repeatedly raised the lack of notice<sup>63</sup> and joinder<sup>64</sup> (albeit without using the label, “due process”). BNY Mellon’s oral argument asserted MERS should have “received notice. MERS does pass on notices it receives to interested parties in the Deed of Trust, and, in this case, that would be my client.”<sup>65</sup> BNY Mellon also cited *In re Tucker*,<sup>66</sup> which quotes from *MERS v. Bellistri*, where a federal district court “held that under Missouri’s tax foreclosure statute, MERS was entitled to notice of

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<sup>61</sup> *State Farm Mut. Auto. Ins. Co. v. Amirpanahi*, 50 Wn. App. 869, 872 n.1, 751 P.2d 329 (1988) (considering on appeal new argument, where below they argued “the basic reasoning ... despite lack of citation to crucial case law and treatises”); *Walla Walla Cnty. Fire Prot. Dist. No. 5 v. Washy. Auto Carriage, Inc.*, 50 Wn. App. 355, 358 n.1 745 P.2d 1332 (1987) (“no rule preventing an appellate court from considering case law not presented below”); *Estate of McKiddy*, 47 Wn. App. 774, 779-80, 737 P.2d 317 (1987) (exercising discretion to consider new argument “arguably related to the issues raised before the trial court”).

<sup>62</sup> Br. of Resp’t at 23; *id.* at 8.

<sup>63</sup> RP 25:2-20; 26:19-27:4.

<sup>64</sup> CP 298:13-14; 302:16-303:17; 306:15-19.

<sup>65</sup> RP 25:2-20. RP 26:19-27:4 (MERS was “listed as the grantee on the very first page. ... they should have named MERS and given them the opportunity to defend ...”).

<sup>66</sup> CP 301:23-25 & n.2 (citing *In re Tucker*, 441 B.R. 638 (Bankr. W.D. Mo. 2010)).

redemption rights” and “also held that MERS held a property interest that was entitled to constitutional protection.”<sup>67</sup> RAP 2.5(a) allows a party may raise a manifest denial of due process at the appellate level for the first time.<sup>68</sup>

BNY Mellon distinguished Scotty’s primary authority as not deciding the issue of entitlement to notice. CP 300:4-7 (“the *Landmark* court acknowledged that it was not deciding whether MERS was entitled to notice of the foreclosure ....”). In stark contrast to the junior mortgagee in the *Landmark* decision who *knowingly* permitted a foreclosure sale to take place, BNY Mellon has been prejudiced – it holds a senior mortgage that cannot be extinguished by the foreclosure of junior lien, it had no notice of the foreclosure, and no sale has taken place.<sup>69</sup>

Scotty’s contends BNY Mellon “has abandoned its claim that MERS had a beneficial interest in the property and should have been joined.” Br. of Resp’t at 20. Not so. The claim has been reiterated many times: Scotty’s should have joined MERS, just as lien claimants did in

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<sup>67</sup> 441 B.R. at 642. *Mortgage Electronic Registration Sys., Inc. v. Bellistri*, 2010 WL 2720802, 2010 U.S. Dist. LEXIS 67753 (E.D. Mo. July 1, 2010). “First, regardless of the validity of MERS’ property interest,” the statute “gives MERS a legal right to notice of the proceedings. ... Second, MERS’ interest as nominee is itself a sufficient property right to trigger a due process right to notice.” 2010 U.S. Dist. LEXIS 67753 at \*32.

<sup>68</sup> *Conner v. Universal Utils.*, 105 Wn.2d 168, 171, 712 P.2d 849 (1986); RAP 2.5(a) (providing for raising on appeal a manifest error affecting a constitutional right).

<sup>69</sup> *Landmark Nat’l Bank v. Kesler*, 289 Kan. 528, 216 P.3d 158, 167-68 (2008).

other cases.<sup>70</sup> “[M]ore than one person can ‘own’ or ‘hold’ an interest in property.”<sup>71</sup>

Scotty’s assumed the litigation risk when it cut out the middleman, MERS, and adopted an outlier theory. Scotty’s view is that MERS was an exclusive agent for Centralbank<sup>72</sup> and the mortgage was worthless.<sup>73</sup> Yet, Scotty’s itself raised MERS’ status as a “common agent” in some instances.<sup>74</sup> Its own pleadings attached an article stating: “As a matter of contract, MERS becomes the agent for a new principal, the next purchasing member, each time there is a transfer.”<sup>75</sup> The same article states: “[T]here is no need to record a mortgage assignment when the note is transferred .... The principle that the ‘mortgage follows the note’ is a common law principle that is codified ....”<sup>76</sup> In response, BNY Mellon observed, MERS plays no further interest once “the noteholder chooses to foreclose in its own name, ... MERS ... will execute the assignment to the foreclosing company .... At this point, MERS no longer holds any legal

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<sup>70</sup> *Summerhill Village HOA*, 270 P.3d 639 ¶¶ 2-5 (association “recorded a lis pendens and served MERS. MERS forwarded the complaint to” the “loan servicer...”); Appellant GMAC Mortg. LLC’s Opening Br. at 6-7 (referring to a default against MERS) in *Summerhill Village HOA*.

<sup>71</sup> *Affiliated FM Ins. Co. v. LTK Consulting Servs., Inc.*, 170 Wn.2d 442, 458, 243 P.3d 521 (2010) (citation omitted).

<sup>72</sup> RP 11:05-14.

<sup>73</sup> CP 440:19-20 (failed “to plead or possess any interest in the underlying note ...”); CP 440:3-441:10 & n.3 (BNY had “no obligation from which to collect on” “received a worthless piece of paper”); RP at 8:21-22 (“there’s nothing for the plaintiff to collect ...”).

<sup>74</sup> CP 56:6-11.

<sup>75</sup> CP 425; *In re Tucker*, 441 B.R. at 646-47 (stating “MERS became the agent for each subsequent note-holder” and the subsequent note holder held a valid lien).

<sup>76</sup> CP 426 (Barkley & Barbara Clark, *MERS Under Attack: Perspectives on Recent Decisions from Kan. and Minn.*, Clark’s Secured Transactions Monthly at 3 (Feb. 2010)).

interest in the mortgage....”<sup>77</sup> In this case, BNY Mellon is the note holder who chose to foreclose and record an assignment for the instrument securing a mortgage note whose value was \$352,000.

BNY Mellon “is the current holder of the note.”<sup>78</sup> Hypothetical facts are appropriately considered in its favor.<sup>79</sup> Those facts are that the mortgage was transferred and became part of a mortgage-backed security before the prior suit was filed.<sup>80</sup> While Scotty’s conceded it had “no idea where the note is ...,”<sup>81</sup> Scotty’s simultaneously asked the trial court to make an impermissible inference: “And if there’s no allegation that BNY Mellon actually holds the note, then they don’t have any interest from which to collect from in this case.”<sup>82</sup> Such an inference is entirely inappropriate. The appropriate inference is that Centralbanc lost all authority when the mortgage note was transferred years earlier.

**D. The 12(b)(6) motion was not converted into a summary judgment motion.**

Scotty’s invokes RAP 9.12, entitled “Special Rule for Order on Summary Judgment.” RAP 9.12 does not apply. The 12(b)(6) motion was

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<sup>77</sup> CP 301:18-20 (citation omitted).

<sup>78</sup> RP 28:23-29:33.

<sup>79</sup> *Bravo*, 125 Wn.2d at 750.

<sup>80</sup> CP 1:17-21; 2:2-13.

<sup>81</sup> RP at 4:3-10.

<sup>82</sup> RP 37:20-38:15.

not converted into a summary judgment motion.<sup>83</sup> Below, BNY Mellon relied upon the stringent standard for granting a pre-answer dismissal.<sup>84</sup> A 12(b)(6) dismissal may consider undisputed documents referenced in the pleadings and public records, without conversion into a summary judgment dismissal.

The pleadings in this case comport with that rule. The complaint attached exhibits,<sup>85</sup> the dismissal motion included additional public records,<sup>86</sup> and the response included an additional public record.<sup>87</sup> Even where the trial court considers extraneous evidence to enable it to make a ruling as a matter of law, “the motion remains one under CR 12(b)(6).”<sup>88</sup> Finally, there was no notice of conversion and “opportunity to present all material made pertinent to such a motion by rule 56.” CR 12(b)(6). If there had been such notice, BNY Mellon would have come forward with evidence proving its hypothetical case, including the records in the appendixes.

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<sup>83</sup> CP 52:21-24 (requesting 12(b)(6) dismissal and citing *Bravo*, 125 Wn.2d at 750); CP 60:26-27 (BNY Mellon “cannot present any set of facts as to the validity of the assignment and its Complaint should be dismissed.”); CP 62:9-12 (“No set of facts can be presented ...); CP 441:8-10 (reply brief stating “This Court should grant Scotty’s 12(b)(6) motion to dismiss ... plaintiff has not made any allegations from which this Court can grant relief.”)

<sup>84</sup> CP 297:10-26; CP 442-43 (order).

<sup>85</sup> CP 2:2-3:15; CP 5-42 (Exs. A-D to Compl.); CP 41 (judgment).

<sup>86</sup> CP 64-288 (attaching mortgages, a parcel map, legal description, notice of trustee’s sale, trustee’s deeds, the findings and conclusions in the prior suit, and Congressional testimony).

<sup>87</sup> CP 295:26-297:6 (attaching Ex. D which was the declaration of John Delaney, omitted by the 12(b)(6) motion); CP 344-45; CP 51:1-3 (referring to testimony).

<sup>88</sup> *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107, 121, 744 P.2d 1032 (1987) (applying 12(b)(6) standard, even though trial court considered materials outside the complaint and made factual finds based upon facts alleged in complaint); *Loger v. Wash. Timber Prods., Inc.*, 8 Wn. App. 921, 924, 509 P.2d 1009, review denied, 82 Wn.2d 1011 (1973) (considered extraneous matters but did not resolve any factual dispute).

**E. The Appendixes contain materials which are appropriate for the review of a 12(b)(6) dismissal.**

Scotty's asks the Court not to consider the documents in the Appendixes to BNY Mellon's Brief and asserts, "all of which BNY Mellon failed to present to the trial court. RAP 10.3(a)(8)." Br. of Resp't at 9. Yet, four of the appendixes were in the record below.<sup>89</sup>

As to the other appendixes, they are at least the basis for the "hypothetical situation" for the purpose of this plaintiff-friendly review of a pre-answer dismissal. If Scotty's had moved for summary judgment, then BNY Mellon would have secured these records and other evidence. The appendixes confirm the absence of a *lis pendens* for Scotty's suit and the discrepancy in the county's parcel index that did not indicate Scotty's lien.<sup>90</sup> They are evidence of Scotty's constructive notice of the recorded assignment of the mortgage to BNY Mellon. They are evidence of Scotty's possible actual knowledge as shown by the subsequent testimony of its attorney about reviewing the title records and discovering a trustee's deed for another mortgage.<sup>91</sup> Those pleadings were filed in the underlying case *after* this appeal was taken. Those pleadings are in the record of appeal

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<sup>89</sup> App. B (BNY Mellon's mortgage, CP 5-8, 10-12, 17); App. D (Assignment to BNY Mellon, CP 30); App. H (Trustee's Deed on BNY Mellon's mortgage, CP 286-87); App. C (Centralbanc's second mortgage, CP 118-19).

<sup>90</sup> App. A (King County Recorder's Index for Parcel 9036, the parcel at issue, and the other parcel, Parcel 9056); App. I (Scotty's Claim of Lien).

<sup>91</sup> App. G (Notice of Trustee's Sale); App. E (Barakos letter); App. J (Decl. of Hans P. Juhl in Case No. 09-2-07414-3), App. K (Pl.'s Opp'n to Def. WMC's Mot. to Set Aside Default and Vacate J.); App. F (King County Recorder's Frequently Asked Questions).

No. 68177-01, *WMC Mortg. Corp. v. Scotty's Gen. Constr., Inc.*<sup>92</sup> BNY Mellon is filing a request for judicial notice of these materials along with the mortgage note and the allonge showing the transfer.

**F. BNY Mellon should be granted its fees.**

While Scotty's below requested an award of fees, Scotty's now contends there is no basis for awarding fees on review.<sup>93</sup> On the one hand, Scotty's argues the provision for an action "to construe or enforce any term of this Security Instrument" does not apply,<sup>94</sup> since it is not a party to that instrument. On the other hand, its case focuses on the construction of the instrument as being a nullity or its priority having been disclaimed. Even if Scotty's is permitted to avoid liability for a fee award under that provision, the construction lien statute is an alternative ground for a fee award.<sup>95</sup> Scotty's admitted below: "The controlling statutes are RCW 60.04.171 and RCW 61.24.005."<sup>96</sup> RCW 60.04.171 is the construction lien's joinder provision that has been litigated extensively in this case. Both parties have asserted claims under the "controlling statute[]," which allows for a

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<sup>92</sup> Case No. 68177-01, Designation of Clerk's Papers (Feb. 10, 2012) (identifying Dkt. 39, 42, 43, 46, 47, which were entries in September 2011), CP 42, 43 in that case.

<sup>93</sup> CP 47:11-13 (requesting an award of fees); *but see* Br. of Resp't at 24. *Cf. Biggers v. City of Bainbridge Island*, 162 Wn.2d 683, 169 P.2d 14 (2007) (in a declaratory judgment action, awarding fees under a land use statute).

<sup>94</sup> CP 19 (Deed of Trust at 15 (fees "in any action ... to construe or enforce any term of this Security Agreement)).

<sup>95</sup> *Id.*; CP 3, ¶ 10 (complaint asserting interest "superior ... under RCW 60.04.061, wherein a mechanic's lien is not prior to a deed of trust ...."); CP 306:2-20 (same).

<sup>96</sup> CP 439:1-2.

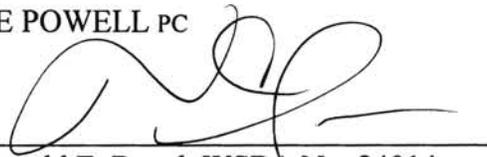
prevailing party to recover fees. RCW 60.04.181(3). Therefore, fees are properly awardable to BNY Mellon.

### III. CONCLUSION

“When an area of law involved is in the process of development, courts are reluctant to dismiss an action on the pleadings ....”<sup>97</sup> That principle has been stood on its head. While established law favored BNY Mellon, Scotty’s relied on a misreading of the relation-back provision and joinder provision in the construction lien statute, along with the assumption that the mortgage was forfeited. The rules of priority were ignored. A trumped up claim of conflict of interest was asserted but later abandoned. There is no insuperable bar to BNY Mellon’s complaint. The dismissal must be reversed and fees should be granted.

RESPECTFULLY SUBMITTED this 23<sup>rd</sup> day of April, 2012.

LANE POWELL PC

BY 

Ronald E. Beard, WSBA No. 24014  
David C. Spellman, WSBA No. 15884  
Carson R. Cooper, WSBA No. 44252  
Attorneys for Attorneys for Appellant

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<sup>97</sup> *Bravo*, 125 Wn.2d at 751.

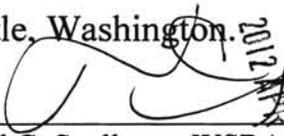
CERTIFICATE OF SERVICE

I, David Spellman, hereby certify that on April 23, 2012, I caused the presentation of the foregoing document to the Clerk of the Court for filing

I further certify that I have mailed the foregoing document by First-Class Mail, postage prepaid, and have emailed the following

Britenae Pierce WSBA #34032  
Ryan, Swanson & Cleveland, PLLC  
1201 3rd Avenue, Suite 3400  
Seattle, WA 98101-3034  
(206) 654-2289  
[pierce@ryanlaw.com](mailto:pierce@ryanlaw.com)  
Attorneys for Respondent Scotty's General Construction, Inc.

Executed on April 23, 2012, at Seattle, Washington.

  
\_\_\_\_\_  
David C. Spellman, WSBA #15884

Address: 1420 Fifth Avenue #4100  
Seattle, WA 98101  
Telephone: 206-223-7000  
E-mail: [spellmand@lanepowell.com](mailto:spellmand@lanepowell.com)  
Attorneys for Appellant

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