

No. 40029-4-II

DIVISION II, COURT OF APPEALS  
OF THE STATE OF WASHINGTON

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Washington Construction, Inc., Plaintiff-Appellant

v.

David Alan Ltd., et al., Defendants,

and

Sterling Savings Bank, Defendant-Respondent

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ON APPEAL FROM PIERCE COUNTY SUPERIOR COURT  
(Hon. Vicki L. Hogan)

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APPELLANT'S BRIEF

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## TABLE OF CONTENTS

	<u>Page</u>
A. INTRODUCTION .....	1
B. ASSIGNMENTS OF ERROR AND ISSUES	3
Assignment of Error No.1 .....	3
Issues Pertaining to Assignments of Error 1.....	3
Assignment of Error No.2 .....	3
Issues Pertaining to Assignments of Error 2.....	3
Assignment of Error 3.....	4
C. STATEMENT OF THE CASE .....	5
1. WCI Was Defrauded Out of Over \$1 Million .....	5
2. Sterling Was Aware of the Fraud, Deliberately Remained Silent, and Knowingly Benefitted From It .....	9
3. Sterling’s Conduct Was Imprudent and Contributed To Its Own Problems .....	18
D. PROCEDURAL STATUS AND RULINGS BELOW .....	18
E. ARGUMENT .....	19
1. Sterling Is Liable to WCI Under the Construction Loan Agreement and Construction Contract As a Matter of Law .....	20
a. All Right, Title and Interest In and To the Construction Contract Was Transferred to Sterling, and Sterling Granted a Limited License to DAD To Utilize the Contract Only So Long It Was Not In Default Of Any Obligation to Sterling .....	20
b. WCI Was a Third-Party Beneficiary of the	

Construction Loan Agreement, At a Minimum for Purposes of Notice To WCI .....	23
2. The Summary Judgment Record Supports Various Equitable Remedies .....	25
a. Estoppel Principles Afford Relief .....	25
(1) Promissory Estoppel and Estoppel By Silence Apply Under the Summary Judgment Record. ...	26
(a) Sterling Had a Duty In Equity and Good Conscience to Notify WCI .....	28
(b) Sterling’s Privacy Notice Did Not Prohibit Sterling From Notifying WCI That Sterling Would Not Release Funds For WCI’s Construction Draws .....	29
(c) In any Event, the Construction Loan Agreement Expressly Authorized Disclosure to WCI. ....	29
(d) If Negligence Concepts of Duty Were to Apply, the Contract, Sterling’s Superior Knowledge, the Unique Circumstances and Sterling’s Partial Disclosure Nonetheless Created a Duty to Notify WCI .....	30
(2) Principles of Equitable Estoppel, Estoppel In Pais, Estoppel By Acquiescence and Equitable Subrogation or Subordination Can Be Extended Under the Record .....	35
b. Unjust Enrichment Principles Afford Relief .....	39
3. WCI Has Legally Viable Claims for Aiding and Abetting a Fraud and Tortious Interference With Contract.....	41
a. The Partial Denial of WCI’s Motion to Amend Was Erroneous .....	41

(1)	Aiding and Abetting a Fraud Is a Viable Claim and Amendment Was Not Futile .....	42
(2).	Sterling Did Not Demonstrate That Amendment Would Cause Undue Prejudice .....	45
b.	The Summary Judgment Record Supports the Claim for Aiding and Abetting the Milne Fraud .....	46
c.	The Summary Judgment Record Supports the Claim for Tortious Interference With Contract .....	47
E.	CONCLUSION .....	49
F.	APPENDIX	
A.	Rita Estates Construction Loan Agreement .....	A-1
B.	Assignment of Plans, Contracts and Entitlements .....	B-1

TABLE OF AUTHORITIES

	<u>Page</u>
<u>Table of Cases</u>	
<i>Activate, Inc. v. Washington State Department of Revenue</i> , 15 Wn. App. 807 (2009) .....	19, 42
<i>Adelphia Recovery Trust v. Bank of America</i> , 624 F. Supp. 2d 292 (S.D.N.Y. 2009) .....	44, 45
<i>Amtruck Factors v. International Forest Products</i> , 59 Wn. App. 8 (1990) .....	31
<i>Auburn Mechanical v. Lydig Construction</i> , 89 Wn. App. 893 (1998) .....	41
<i>Baker v. Leigh</i> , 238 Ark. 918, 385 S.W.2d 790 (1965)) .....	38
<i>Bank of America v. Prestance Corporation</i> , 160 Wn. 2d 560 (2007) .....	38
<i>Blosam Contractors v. Republic Mortgage Investors</i> , 353 So.2d 1225 (Fla. 1977) .....	40
<i>Business Factors v. Taylor-Edwards</i> , 21 Wn. App. 441 (1978) .....	36
<i>Central Heat, Inc. v. The Daily Olympian, Inc.</i> , 74 Wn.2d 126 (1968) .....	27, 28, 36
<i>Chemical Bank v. WPPSS</i> , 102 Wn.2d 874, 901 (1984) .....	26, 27, 36
<i>Colonial Imports, Inc. v. Carlton Northwest, Inc.</i> , 121 Wn.2d 126 (1993) .....	35, 36
<i>Colo. Structures, Inc. v. Insurance Co. of the West</i> , 161 Wn.2d 577 (2007) .....	21

<i>Cox v. Wooten Bros. Farms, Inc.</i> , 271 Ark. 735, 737-38, 610 S.W.2d 278, 280 (1981) .....	38
<i>Dale v. Ala Acquisitions, Inc.</i> , 2003 F. Supp. 2d 694 (2002) .....	45
<i>Dana v. Boren</i> , 133 Wn. App. 307 (2006) .....	5
<i>Davin v. Dowling</i> , 146 Wash. 137 (1927) .....	43
<i>Denny's v. Security Union Title Ins.</i> , 71 Wn. App. 194 (1993) .....	42
<i>Diodati v. Brown, Todd &amp; Heyburn</i> , 693 F. Supp. 1259 (D. MA 1988) .....	45
<i>El Camino Resources, Ltd. v. Huntington National Bank</i> , 2009 U. S. Dist. Lexis 13143 (W.D. Mich. 2009) .....	45
<i>Embree Construction Group, Inc. v. Rafcor, Inc.</i> , 330 N.C. 487, 411 S.E. 2d 916 (1992) .....	40
<i>Foman v. Davis</i> , 371 U.S. 178 (1962) .....	46
<i>Haberman v. WPPSS</i> , 109 Wn.2d 107 (1987), appeal dismissed, 488 U. S. 805 (1988) .....	31
<i>Herron v. Tribune Publishing Co.</i> , 108 Wn.2d 162 (1987).....	41, 42
<i>Home Sav. Bank v. Bierstadt</i> , 168 Ill. 618,48 N.E. 161 (1897) .....	38
<i>Irwin Concrete v. Sun Coast Properties</i> , 33 Wn. App. 190 (1982) .....	39
<i>Kim v. Lee</i> , 145 Wn.2d 79, 88 (2001) .....	37
<i>Lacy v. Wozencraft</i> , 188 Okla. 19 (1940) .....	28
<i>Lamm v. McTighe</i> , 72 Wn.2d 587 (1967) .....	36
<i>Lonsdale v. Chesterfield</i> , 99 Wn.2d 353 (1983) .....	23, 24
<i>Mahler v. Szucs</i> , 135 Wn.2d 398 (1998) .....	37

<i>Martin v. Abbott Laboratories</i> , 102 Wn.2d 581 (1984) .....	44
<i>Miller v. Mountain View Sav. &amp; Loan Assn.</i> , 48 Cal. Rptr. 278, 238 Cal. App. 2d 644 (1965) .....	40
<i>Newton Ins. Agency &amp; Brokerage, Inc. v. Caledonian Ins. Group, Inc.</i> , 114 Wn. App. 151 (2002) .....	47
<i>Pleas v. City of Seattle</i> , 112 Wn2d 794 (1989) .....	47, 48
<i>Rummens v. Guaranty Trust Co.</i> , 199 Wash. 337 (1939) .....	25
<i>Safeco v. Butler</i> , 118 Wn.2d 383 (1992) .....	36
<i>Sorenson v. Pyeatt</i> , 158 Wn.2d 523 (2006) .....	37
<i>Swinderton &amp; Walberg Co. v. Union Bank</i> , 25 Cal. App. 3d 259, 101 Cal. Rptr. 665 (1972) .....	40
<i>Tagliani v. Colwell</i> , 10 Wn. App. 227 (1973) .....	20, 42, 46
<i>Tokarz v. Frontier Federal Savings and Loan Ass'n</i> , 33 Wn. App. 456 (1983) .....	31, 32, 33
<i>Thomas v. Casey</i> , 49 Wn.2d 14 (1956) .....	43, 44
<i>Town Concrete Pipe v. Redford</i> , 43 Wn. App. 493 (1986) .....	39, 40
<i>Tri-City Construction Council, Inc. v. Westfall</i> , 127 Wn. App. 669 (2005) .....	37
<i>Walla v. Johnson</i> , 50 Wn. App. 879 (1988) .....	20
<i>Wells Fargo Bank v. Arizona Laborers</i> , 201 Ariz. 474, 38 P.3d 12 (2002) .....	31, 32, 43, 44
<i>Westview Invs. Ltd v. U.S. Bank</i> , 133 Wn. App. 835 (2006) .....	44

Rules

CR 15(a)..... 42

Other Authorities

Restatement (Third) of Agency §§ 6.01 and 6.02..... 5

Restatement (Second) of Torts § 867(b)..... 42

## A. INTRODUCTION

Washington Construction, Inc. (WCI) is appealing the summary judgment dismissal of its claims against Sterling Savings Bank (Sterling). WCI's claims raise a number of issues arising from Sterling's Construction Loan for a plat development near Gig Harbor called Rita Estates. It is undisputed that WCI, the general contractor, was defrauded out of over \$1 million by Sterling's Borrower. The Borrower induced WCI to perform substantial work on the project by false assurances of timely payment under its Construction Loan Agreement with Sterling. Concealed from WCI was the fact that Sterling had no intent to release loan funds for WCI's work.

At issue on this appeal is whether law and equity afford WCI no remedy against Sterling when the record supports findings that 1) the Construction Loan Agreement transferred to Sterling all of the Borrower's rights in and to WCI's Construction Contract, and 2) Sterling was aware of its Borrower's fraud, the fraud could not have occurred without Sterling's deliberate silence, Sterling's own conduct facilitated the fraud, and Sterling knowingly benefitted from allowing it to proceed. Sterling knew that real estate values were plummeting while WCI's work was protecting and improving the property which secured Sterling's prior loan advances to the Borrower.

Sterling contended below that its defrauding Borrower's privacy rights prohibited Sterling from contacting WCI and that Washington law provides no recourse to WCI. The trial court apparently agreed with Sterling, denying WCI leave to amend its complaint to add an aiding and abetting theory of recovery (which Sterling contended is not recognized in Washington), and subsequently dismissing as a matter of law all other legal and equitable claims raised by WCI.

WCI submits that denying a remedy under these circumstances would disserve the interests of justice and sound public policy. What Sterling did to WCI was wrong, and actionable. A simple phone call, email or any of a variety of other actions by Sterling which were expressly authorized (and arguably required) by the Construction Loan Agreement would have prevented the financial devastation of a contractor and substantial damage to its subcontractors and suppliers. On the other hand, permitting a bank/construction lender to remain silent to reap benefits from a known fraud would serve no public interest. Any of a number of legal and equitable remedies should afford relief under the facts here, if proven to a jury.

The specific legal issues come to this Court under the following assignments of error and issues thereunder.

## **B. ASSIGNMENTS OF ERROR**

Assignment of Error 1: The trial court erred by denying WCI leave to amend its complaint to add aiding and abetting a fraud and other theories for recovery based on the same facts as previously alleged.

Issue 1: Was amendment futile, or does Washington law recognize aiding and abetting liability as set forth in Restatement (Second) of Torts §876(b) and other authorities?

Issue 2: Did the trial court abuse its discretion because Sterling did not demonstrate undue prejudice when the underlying fraud and facts supporting aiding and abetting were already a central part WCI's prior complaint, the court allowed amendment to include another tort claim based on the same facts, the motion to amend preceded Sterling's motion for summary judgment, and discovery had not closed, Sterling had not yet deposed anyone, and no additional discovery or witnesses would have been required?

Assignment of Error 2: The trial court erred by dismissing WCI's claims as a matter of law when the evidence of record, and reasonable inferences therefrom, demonstrated factual issues that permit a jury to find Sterling liable under a variety of legal and equitable bases.

Issue No. 1: Did Sterling's Construction Loan Agreement, including the assignment and transfer of WCI's Construction Contract to

Sterling, require Sterling to notify WCI of the assignment and transfer or that Sterling would not release funds for WCI's work?

Issue No. 2: Do estoppel principles apply under the facts here to prevent Sterling from refusing to release funds to pay for the property improvements it knew WCI was making in reliance on the Construction Loan Agreement?

Issue No. 3: Do principles of equitable subrogation or subordination or other equitable doctrines apply to place WCI's lien rights prior to Sterling's?

Issue No.4: Do principles of unjust enrichment apply to compel Sterling to pay for the benefit conferred on and knowingly accepted by Sterling?

Issue No. 5: Does the court have the power to fashion other appropriate equitable relief to achieve a just result?

Issue No. 6: Do the facts of record, and reasonable inferences therefrom, support claims for tortious interference with contract and aiding and abetting a fraud?

Assignment of Error No. 3: The Court abused its discretion by denying leave to amend the complaint, if any amendment is required, in its amended summary judgment order.

### C. STATEMENT OF THE CASE

The evidence of record, and reasonable inferences therefrom, would permit a jury to find the following facts. A more complete summary appears at *CP 748-59* and the record cites therein. While WCI relies upon the entire record, the core evidence consists of the Lisa Irwin Deposition and Exhibits (*CP 379-531 & 684-701*), the Cynthia Altheide Deposition (*CP 883-903*) and Exhibits (*CP 598-604*), the Sandy Smith Deposition and Exhibits (*CP 547-85*) and the Kurt Smith Deposition (*CP 586-97*).

#### 1. WCI Was Defrauded Out of Over \$1 Million.<sup>1</sup>

WCI is a small excavating company solely owned by Kurt Smith. Kurt's sister, Sandy Smith, helped in the office. *CP 548 (S Smith Dep. at p11 line 24 – p12 line 17)* On August 19, 2009, WCI contracted with David Alan Development LLC (DAD), through DAD's agent David Alan Ltd.,<sup>2</sup> for site work on a plat development called Rita Estates. (The Construction Contract appears in the record at *CP 147-53*.) David Alan

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<sup>1</sup> Sterling does not deny its Borrower's fraud on WCI (see, e.g., *CP 239 ¶ 8.5 & CP 240 ¶ 10*).

<sup>2</sup> Milne told Kurt Smith that David Alan Ltd. was the agent for DAD (*CP 588, p.20 lines 8-14; and CP 591, p37 line 13 – p38 line 5.*), and the Milnes, DAD and David Alan Ltd. have all admitted that David Alan Ltd. was DAD's agent. *CP 22 ¶2 & CP 41-42, ¶¶ 1&3.*) WCI's Construction Contract was therefore with DAD. *Restatement (Third) of Agency*, at sections 6.01 and 6.02 ("When an agent acting with actual or apparent authority makes a contract on behalf of a [disclosed or an unidentified] principal, (1) the principal and the third party are parties to the contract...." Accord, *Dana v. Boren*, 133 *Wn. App.* 307, 311 & 313 (2006).

Milne (Milne) owned and managed both the principal and agent companies. *CP 22 ¶4 & CP 42 ¶3; CP 383 (Irwin Dep at p32 lines 8-20)* The Contract price was \$995,544 (\$1,081,161 with tax). Before entering into the Construction Contract and commencing work, WCI requested verification of adequate financing. Milne showed Kurt Smith a loan folder which included the Sterling Construction Loan Agreement in the amount of \$3,050,000, Sterling's approved construction budget for the loan, and an email from Lisa Irwin, Sterling's Loan Officer,<sup>3</sup> encouraging Milne to start the Project rather than wait until the following Spring. *CP 589 & 592 (K Smith Dep at p21 line7 – p22 line 25 & p46 line 6 - p48 line 2)*<sup>4</sup> The Construction Contract, at ¶ 7, explicitly called for this initial and ongoing verification of financing as a condition of starting and continuing the work. *CP 148*

The Construction Contract required WCI to perform the work at an extraordinary pace to beat Fall rains and meet an impending plat recording deadline of March 2009. *See, e.g., CP 593 & 596 (K Smith Dep at p51 line 19 – p52 line 14 & p67 lines 14-23; & CP 487 & 513 (DepEx 35 & 45)* It provided for first payment after 60 days (progress invoice after 30

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<sup>3</sup> Lisa Irwin and her manager, Cynthia Altheide, were employees of Action Mortgage Company, a subsidiary of Sterling Savings Bank, which handled the loan transaction for Sterling. At some point they became direct employees of Sterling. *CP 380 at p9 line 18 – p10 line 3 & CP 891 at pp41-43*

<sup>4</sup> The construction budget referred to was approved by Sterling. *CP401(Irwin Dep at p113 and CP 462 & 463-64 (DepEx19 &22)* The Irwin email is discussed *infra* at 11.

days and payment due within 30 days thereafter). *CP 149* WCI immediately started logging and clearing the forested site. *CP 487 (DepEx 35); CP 596 & 597 (K Smith Dep at p64 line 23 – p67 line 33 & p69 line 4 – p70 line 15)* Within days, the site was virtually stripped of vegetation, and excavation had begun. *Id. & CP 513 (DepEx45)*

Thereafter, Milne and DAD repeatedly indicated that all was on track with Sterling and assured that WCI would be timely paid from the Construction Loan. *See CP 554-65 (S Smith Dep at p47 – p90 line 1) & CP 591 (K Smith Dep at p39 - p40 line7)* For example, when Sandy Smith requested verification of financing and copies of the documents for her project file, DAD again provided the Construction Loan Agreement and construction budget previously shown to Kurt Smith. *CP 558-59 (S Smith Dep at p63 line7 – p66 line 24; & CP 579-81 (DepEx 87 & 89)* WCI therefore agreed to transfer a Department of Ecology permit to WCI, and WCI deposited a cash bond with Gig Harbor. *CP 557 (S Smith Dep at p58 line6 - p60 line 2); & CP 568-78 (DepEx 85 & 86)*

WCI submitted its progress invoice on September 19 for \$634,939.22 (after deducting retainage) for work through that date, and expected payment by October 20 per the Construction Contract. On October 9, 2008, to appease its own bank, WCI sent Milne a letter requesting confirmation that WCI would receive timely payment by

October 20. CP 561 (S Smith Dep at p76 lines 4-22) WCI was again assured of timely payment from the Sterling loan. CP 562 (S Smith Dep at p78 lines 12-18)

In addition to these assurances, Milne's request for work on another Milne/Sterling project and Sterling's direct payment therefor furthered the perception that all was in order. Milne asked WCI do some winter stabilization on another project with Sterling, the Cook Addition development in Poulsbo. Prior to performing that work, WCI requested proof of financing, received confirmation that Sterling loan funds were in place to pay for the work, and **Sterling paid WCI directly** for that work. CP 549, 559-61 & 563 (S Smith Dep at p15 lines 14-20, p68 line 24 – p73 line 25 & pp81-82); & CP 582-83 (DepEx 91) Lisa Irwin, Sterling's Loan Officer for both Cook Addition and Rita Estates, had direct contacts with Sandy Smith about the Cook Addition contract, and neither Milne nor Irwin gave WCI any indication of any problem with the loans on either project. *Id.*; CP 422-24 (S Smith Dep at p176 line 12 – p177 line 20 & p186 line 2 – p187 line 16); CP 427-28 (Irwin Dep at p196 line 5 – p197 line 12); CP 511-12 & 514-16 (Dep. Exh. 46); & CP 564 (S Smith Dep at p85 lines 4-8)

On October 15 and 16, WCI was told that the Project Engineer had certified the vast majority of WCI's September 19 invoice for

payment, and that the certification, with Milne's concurrence, had been provided to Sterling for payment. WCI was led to believe that Sterling's payment on the first progress request was imminent. *CP 563 (S Smith Dep at pp81-82)* WCI prepared and submitted its next progress invoice on October 16, showing \$863,533 for work to that date (excluding retainage). *CP 562-63 (S Smith Dep at pp78-82) & CP 584 (DepEx 97)* Work was nearing completion and continued at a rapid pace.

October 20 came and passed without payment to WCI. *CP 563-65 (S Smith Dep at p84 – p90 line 2)* After some initial excuses by Milne (e.g., saying that Sterling's checks were cut in Spokane and had to be mailed – *CP 564 (S Smith Dep at p86 lines 4-14)*), WCI asked its counsel to investigate, leading to the discovery of the fraud. *CP 377-78 ¶ 9 & CP 698-99 (K Smith Dep)* By then, the work was almost complete. The nonpayment threw WCI into financial turmoil and WCI was unable to pay its subcontractors and suppliers. *CP 597 (K Smith Dep at p72)*

2. Sterling Was Aware of the Fraud, Deliberately Remained Silent, and Knowingly Benefitted From It.

Milne was a Sterling Private Banking customer, and Rita Estates was Sterling's third project with Milne and his entities. The first had been successfully completed, and the Second (Cook Addition) was in progress at the time of the Rita Estates Agreement. *CP 381-89 (Irwin Dep)* The

Borrower on Cook Addition was James Alan Ltd., and DAD and David and Virginia Milne were Guarantors. *Id.* & CP 286 David and Virginia Milne were also Guarantors on Rita Estates. CP 392-93 (*Irwin Dep at p88*) Sterling conducted all the due diligence it desired on Milne's financial condition and project value before entering into the Rita Estates Agreement and was satisfied that Milne was capable of repaying the loan. CP 392-93 & 400 at p108 (*Irwin Dep*) It had an over 1½ foot thick file of financials and tax returns which Sterling reviewed for Cook Addition, and it updated the financial information for Rita Estates. CP 384 & 392 (*Irwin Dep at pp38-39 & pp85-86*)

The November 5, 2007, Rita Estates Construction Loan Agreement was for \$3,050,000, of which Sterling advanced about \$1.5 million for DAD's purchase of the property, loan fees, appraisal costs and some other costs. (The Rita Estates Construction Loan Agreement is provided in Appendix A.) Work on Rita Estates was delayed because it could not be performed efficiently in winter. CP 402 (*Irwin Dep at p120*) Milne's Cook Addition contractor was originally proposed to work on Rita Estates, until Milne had a dispute with that contractor in April of 2008 resulting in an \$833,000 lien against Cook Addition. CP 403-04 (*Irwin Dep at pp121-28*); & CP 465-69 (*DepEx 24 & 25*)

On June 2, 2008, Milne emailed Lisa Irwin, asking if he should start Rita Estates or wait until the following Spring. There was adequate interest reserve to wait, but the plat recording deadline was March 2009. Aware of the contractor lien for \$833,000 on Cook Addition and that the contractor indicated it had started work before Sterling recorded its deed of trust, and despite her knowledge of a declining real estate market, she emailed him back, encouraging him to start work on Rita Estates. *CP 470 (DepEx 28)* She testified about her email to Milne as follows:

Q. "My preference would be for you to start on the Gig Harbor project." I'm reading the e-mail. "As you can well imagine, the banks are getting nervous about land values, I don't know if waiting for a marketable product would be the way to go." First of all, "the banks are getting nervous about land values," what do you mean by that?

A. That the values of our projects are declining because land values are going down.

....

Q. "I don't know if waiting for a marketable product would be the way to go," what do you mean by that?

A. I know what I mean, what I said, but I don't know that it is coming out that way.

Q. Okay, what did you mean?

A. Well, if we waited for the market, the land values would deteriorate even further

*CP 405-06 (Irwin Dep at p130 line 6 – p131 line 2 & p131 lines 13-20)*

Poor market conditions were the primary risk factor on the loan, and her mistaken belief was that the residential real estate market would rebound in 2009. *CP 399-99 (Irwin Dep at pp101-02)*

Milne signed a contract with another contractor and submitted a draw request for a “retainer” to have him start work. On July 2, Lisa Irwin advised Milne that Sterling would not pay “retainers” and that the contract amount was over budget. *CP 407-07 (Irwin Dep at pp133-34)* She told him that he might get a better price because contractors were hungry due to the poor market, and he should try to get a price closer to budget. *CP 409 & 411 (Irwin Dep at p139 & pp143-44)*

On August 7, Lisa Irwin received a copy of a fax from Milne to his contractor advising that he had been instructed to re-bid. *CP 412 (Irwin Dep at p146 line 10 - p147)* Milne obtained proposals from WCI, agreed on a form of proposal on August 18, signed the WCI Construction Contract on August 19, and directed WCI to start work. WCI immediately started logging and stripping the site. See *supra* at 7.

Milne and Irwin met on August 20. They discussed the Cook Addition project, and Milne told her that he had contracted with WCI for Rita Estates and work had started. She told him that she had not approved the WCI contract,<sup>5</sup> and told Milne to stop work. Milne responded that he could not just stop the work because WCI was stripping the site and

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<sup>5</sup> The Construction Loan Agreement does not require Sterling’s “approval” before starting work. It provides only that *if* requested, Borrower shall provide a list of contractors prior to advances being made. (App. A hereto, at pp.2. & 8 of the Agreement) Lisa Irwin got everything she asked for. She had not required or provided written approval for the Cook Addition contractor, and it was not her custom and practice to require such written approval. *CP 402 (Irwin Dep at p119 line 16 - p20 line 2)*

erosion damage would result. He also told her he would lose the plat entitlements in March 2009. She requested information about WCI. *CP 413-16, 418 & 421-22 (Irwin Dep at pp 151-60, pp164-65, & p176)* DAD provided the requested WCI information and contract by noon that day, immediately followed by other information regarding Milne's decision to start work. *CP 416-17 (Irwin Dep at pp61-64); & CP 476-507 (DepEx 34 & 35)* Lisa Irwin reviewed the WCI Construction Contract, (*CP 431, Irwin Dep at 203*), and therefore knew of the adequate financing condition for WCI's start of work and ongoing performance, the fast pace of the work, and the payment terms. She was also aware of the impending plat recording deadline and potential erosion, see *supra*, and possible off-site damage and DOE fines if WCI's work were to stop (see *CP 422, Irwin Dep at p177*, acknowledging such threats to Cook Addition).

The next day, using the contractor lien as a basis, Lisa Irwin's manager, Cynthia Altheide, mailed a notice dated August 21 defaulting the Cook Addition Borrower (James Alan Ltd.) and Guarantors (DAD and the Milnes) and demanding "immediate" payment of the \$7,122,390 advanced and another \$1,300,000 for completion of Cook Addition. *CP 508-09 (DepEx 36) & CP 418 (Irwin Dep at 165-66)* Altheide also sent a second letter entitled "Notice of Cessation of Advances" stating unequivocally that Sterling "will make no further advances concerning the Construction

Loan Agreement and Promissory Note dated November 5, 2007 [the Rita Estates agreement and note].” *CP 510 (Dep Ex 37) & CP 418 (Irwin Dep at pp168-70)* The sole basis for the Notice of Cessation was that the financial condition of DAD and the Milnes (the Borrower and Guarantors on Rita Estates) had deteriorated because of Sterling’s simultaneous Cook Addition default and demand for payment from them. *CP 897(Altheide Dep at p62 lines 12-16)* It was not based on any contention that Sterling had not “approved” the WCI contract. Altheide did not even know that WCI had started work. Irwin never told her. *CP 898 (Altheide Dep at pp65-68)* Irwin was unaware of any financial deterioration of DAD and Milnes other than that caused by Sterling’s Cook Addition demand. *CP 420 (Irwin Dep at 171–72)* The default, demand and cessation were without prior notice or opportunity to cure. *Id.*

Although Lisa Irwin knew that WCI was stripping Rita Estates, and Milne had told her that he could not stop WCI’s work without damage to the site, she did not call, email, or fax Milne to tell him the letters were coming. She did not consult with Altheide about WCI or tell her that WCI had started work. *CP 419 (Irwin Dep at pp169-70); CP 898 (Altheide Dep at pp65-69)* She did not contact WCI. *CP 419 (Irwin Dep at p170)* She did not ask Milne for consent to meet with or talk to WCI (if she felt that was needed). She did not even read the Construction Loan

Agreement to determine what she could or ought to do.<sup>6</sup> *CP 429 (Irwin Dep at p199 lines 15-22)* By the time Milne received the default and cessation letters, the property was virtually stripped (*CP 513, DepEx 45*), and the cost to protect the site (if work were then halted) had increased enormously. *CP 594-97 (K Smith Dep at pp60-79)*

On September 2, Lisa Irwin received WCI's proposal for winter stabilization of Cook Addition. *CP 422 (Irwin Dep at 176)* She knew there would be significant damages and DOE fines if off-site damage occurred, so she requested and obtained approval from her Sterling superiors for WCI to do the work, notwithstanding the default notice. *CP 423-24 (Irwin Dep at p186)* Sterling paid WCI directly for that work. *CP 563 (S Smith Dep at p81-82)* Erosion concerns on Rita Estates were probably more serious because of the sloped, deforested nature of the site and nearby salmon stream, and, unlike Cook Addition, no detention ponds or other control systems had yet been constructed. *See CP 595 & 596 (K Smith Dep at p63 line 5 – p64 line 22 & p65 line 18 – p66 line 1)*

Milne continued to notify Lisa Irwin that WCI was working diligently on Rita Estates, and he tried to get Sterling to pay WCI directly for WCI's "solid" work. (*See, e.g., CP 424 (Irwin Dep at p191)*): email

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<sup>6</sup> The Construction Loan Agreement for Rita Estates was apparently a relatively new form used by Sterling, as it differed materially from that used for Cook Addition just a few months before. (Compare *CP 275-83* with *CP 295-305* (App A hereto))

from Milne asking that Rita be “reinstated” because “WCI is working their butt off to save this plat from winter damage...; CP 425-26 & 513 (*Irwin Dep at p192 & 195; and DepEx 45*) – email from Milne saying he would stop work only if 1) WCI were paid for its work to date, and 2) Sterling assume responsibility under the NPDES permit.) Irwin still did not notify WCI, stop WCI’s work, or respond to WCI’s draw request. *See CP 426 & 430 (Irwin Dep at p195 & p201)*

While WCI was diligently working on Rita Estates, Lisa Irwin communicated directly with Sandy Smith about WCI’s contract for the Cook Addition winter stabilization. *CP 427-28 (Irwin Dep at pp196-97)* She still did not, however, inform WCI of any problems with either the Cook Addition or Rita Estates Construction Loans. She testified:

Q. And you knew that Washington Construction was relying on payment from Sterling Savings Bank for payment for that site stabilization work on Cook, right?

A. Yes.

Q. And had you ever advised Washington Construction that a notice of default had been issued in connection with the Cook Addition project?

A. No.

Q. Are you aware at any time Washington Construction had knowledge that a notice of default had been issued on the project it was getting paid to stabilize?

A. No.

Q. After receiving the information from David Milne that he wouldn't stop work unless there were conditions met and after agreeing to pay Washington Construction for work on the Cook Addition project, did you advise Washington Construction that there was a notice of cessation of advances on the Rita project?

- A. No.
- Q. Why not?
- A. Because Washington Construction was not my customer on the Rita project.
- Q. Why didn't you notify them?
- A. It's a privacy issue with the bank. We don't contact any of our contractors.
- Q. Well, you entered into a loan agreement with David Alan Development for the Rita project, right?
- A. Yes.
- Q. And you are aware that in that loan agreement it authorizes Sterling Savings Bank to communicate directly with any contractor on the project?
- A. Yes, it may say that in the documents.
- Q. It does say that?
- A. It may say that, I said.
- Q. Did you look to see?
- A. No.
- Q. Had you been told not to communicate with Washington Construction?
- A. We don't communicate with the contractors on our projects.
- Q. Had you been told not to communicate with Washington Construction on this project?
- A. Not specifically, no.

*CP 428-29 (Irwin Dep at pp197-200)*

While Lisa Irwin allowed WCI to continue to enhance and protect the site, she was well aware that residential real estate values were continuing to decline (*CP 430, Irwin Dep at p 200-01*), that the plat recording deadline was approaching and work had to be completed prior to winter weather (*CP 42, Irwin Dep at p193*), and that erosion damage and fines were likely if WCI stopped work (*CP 513, DepEx 45*), all of

which could seriously jeopardize Sterling's security for the loan advances already made.

3. Sterling's Conduct Was Imprudent and Contributed To Its Own Problems.

While the above facts form the core of WCI's claims, WCI relies upon the entire record and totality of the circumstances. Additional facts evidencing Sterling's imprudent conduct in granting and administering the loans were summarized below at *CP 763-67*.

**D. PROCEDURAL STATUS AND RULINGS BELOW**

WCI filed a lien against Rita Estates and this suit in November 2008. The complaint alleged fraud and other claims against the Milne Defendants, claims against Sterling, and it joined other lien claimants for purposes of lien foreclosure. WCI amended the complaint twice, primarily to join additional lien claimants. On August 4, 2009, prior to the October 26 close of discovery, WCI moved to amend to add claims against Sterling.<sup>7</sup> *CP 47-69; 70-75 & 76-82* The trial court orally ruled that WCI could add tortious interference with contract claims, but denied the motion insofar as it sought to join Kurt Smith as an individual plaintiff and with respect to other WCI claims, including a claim for aiding and abetting the

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<sup>7</sup> WCI also moved to join The Blackstone Corporation, which Sterling had recently appointed as Trustee of the Rita Estates Deed of Trust, and had scheduled a Trustee's sale of the property to occur before trial of the lien foreclosure and other claims in this suit. The motion to join the Blackstone Corporation and related claims was granted. The Trustee's sale was later postponed due to DAD's bankruptcy filing.

Milne fraud. Prior to entry of a written order, WCI moved for partial reconsideration, limited to the ruling with respect to WCI's claims for aiding and abetting a fraud. *CP 87-106; 109-15 & 116-26* The Court denied the motion for reconsideration and entered a written order partially granting and partially denying the motion to amend. *CP127-28* DAD and the Milnes subsequently filed bankruptcy petitions.<sup>8</sup>

Sterling moved for summary judgment with respect to WCI's claims. *CP 220-375; 376-803, 871-920; & 836-67* The trial court granted Sterling's motion on October 23. *CP 921-23* WCI moved to amend and clarify the order and, out of an abundance of caution, for leave to amend the complaint to the extent it may be deemed necessary. *CP 924-45; 946-64; & 965-72* The trial court clarified and amended its summary judgment order, denied leave to amend, and certified the summary judgment as final under CR 54(b). *CP 973-75*

#### **E. ARGUMENT**

WCI respectfully submits that the trial court erroneously granted summary judgment dismissing WCI's claims against Sterling. This Court reviews the summary judgment record de novo. *Activate, Inc. v. Washington State Department of Revenue*, 15 Wn. App. 807, 812 (2009) Sterling has the burden of establishing the absence of any material facts,

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<sup>8</sup> The DAD bankruptcy petition was subsequently dismissed, as DAD had filed pro se.

and that it is entitled to summary judgment as a matter of law. All facts and inferences must be drawn in WCI's favor, and summary judgment is appropriate only if only one conclusion could be reached from all the evidence. *Id.* The facts of record, and reasonable inferences therefrom, support each of the following claims.

1. Sterling Is Liable to WCI Under the Construction Loan Agreement and Construction Contract As a Matter of Law.

Sterling had an obligation to notify WCI that all rights to the Construction Contract had been transferred to Sterling, or at least that Sterling would not advance funds for WCI's work.<sup>9</sup>

*a. All Right, Title and Interest In and To the Construction Contract Was Transferred to Sterling, and Sterling Granted a Limited License to DAD To Utilize the Contract Only So Long It Was Not In Default Of Any Obligation to Sterling.*<sup>10</sup>

The Construction Loan Agreement includes an "Assignment of Plans, Contracts and Entitlements" CP 709-10 (provided in Appendix B hereto) The Agreement does not merely create some putative future right.

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<sup>9</sup> Even if the contract had not obligated Sterling to notify WCI, it nonetheless refutes Sterling's contention that it was prohibited by DAD's privacy rights from contacting WCI. See *infra* at 30-31.

<sup>10</sup> The trial court's amended summary judgment order held that WCI had not pled a claim based on assignment, and denied leave to amend to add it, if necessary. WCI's complaints clearly alleged that Sterling was obligated to pay WCI under the Construction Loan Agreement. CP 8, 28-29, & 812-13 at ¶¶ 21 & 24. It is not necessary to plead all supporting contract provisions supporting the claim. And even if it were, then amendment should have been permitted to clarify the claim bases. The issue had been fully briefed and argued on the merits. *Tagliani v. Colwell*, 10 Wn. App. 227, 233 (1973). See also *Walla v. Johnson*, 50 Wn. App. 879, 883 (1988) (failure to state reasons for denial can be abuse of discretion.)

Rather, it states that “Borrower **hereby assigns, transfers,** and pledges ...to Lender **all of its rights,** powers and privileges” and “**all of its right, title and interest in and to**” the Construction Contract and other Project Documents. *Appendix B ¶1 (emphasis added.)* Sterling then “licensed” back to DAD rights to “utilize” the Construction Contract and the other Project Documents, but only so long as “no default exists under any of the Loan Documents....” (*Id. at ¶2*) If any default exists, then “Borrower’s **license ... shall cease and terminate without the execution of any further instrument or document or the taking of any other act on the part of the Lender...**” *Id.* Upon the occurrence of a default, Sterling is DAD’s attorney-in-fact to use the Project Documents and perform any and all acts that Sterling deems necessary or desirable. *Id. at ¶3* The Borrower agrees to indemnify Sterling for any liabilities arising out of the Assignment. *Id. at ¶ 8* Under the Construction Loan Agreement, DAD is in “default” if it

fails to comply with or to perform any term, obligation, covenant or condition contained **in any other agreement between Lender and Borrower.**

*Appendix A: Agreement at p7 (emphasis added)* Default under such contract language does not require a “declaration” of default by Sterling. See *Colo. Structures, Inc. v. Ins. Co. of the W.*, 161 Wn.2d 577, 591-92 (2007) Sterling, in fact, admits that DAD’s failure immediately to pay the

over \$10 million per Sterling's demand under the Cook Addition default notice was also a default under the Rita Estates Construction Loan Agreement. *CP 236-37 at ¶¶ 6.2-6.5* By operation of the assignment and transfer, DAD's rights in the Construction Contract were terminated, and Sterling had exclusive rights thereunder.

Sterling argued below that the agreement creates no duty to WCI because it recites that the assignments and transfers therein do not constitute "an assumption on the part of Lender of any duty or obligation" with respect to the assigned documents (*Appendix B ¶4.*). This disclaimer, however, must be read in context with the other provisions, and the contract must be interpreted to effectuate all of the contract provisions. *Colo. Structures, supra*, 161 Wn.2d at 588 If read as broadly as Sterling urges, ¶4 would render the prior provisions meaningless. If, as explicitly stated, DAD has transferred all rights in and to the Construction Contract and other Project Documents to Sterling, and DAD's "license" to even "utilize" the documents were automatically "terminated" by its default, who then owes the duties of notice and termination or other obligations under the Construction Contract? Indeed, DAD's rights to use permits, plans and other Project Documents necessary for DAD to perform the Construction Contract were also terminated. In short, this is not just an assignment of proceeds or of certain rights. It "transfers" "all rights in and

to” the Construction Contract to Sterling and “terminates” DAD’s right under and the ability to perform the Construction Contract.

Paragraph 4 must be reconciled with ¶¶ 1, 2 and 3, and consistently with principles of good faith and fair dealing with WCI, whose rights and obligations are significantly affected by the assignment and transfer. The ¶4 disclaimer must therefor apply only so long as the Borrower is not in default and is performing under the Construction Contract and Construction Loan Agreement. Even upon default, Sterling may still avoid responsibility by suspending or terminating the work. But Sterling, having the exclusive rights in and to the Construction Contract, cannot simply do nothing and accept the benefits of WCI’s ongoing performance thereunder. Sterling must notify WCI of the assignment and transfer, and, if it does not want the work to continue, it must stop it. At a minimum, it must notify WCI that it does not intend to pay for the work.

Having given no notice to WCI whatsoever, Sterling is liable.

*b. WCI Was a Third-Party Beneficiary of the Construction Loan Agreement, At a Minimum For Purposes of Notice To WCI.*

Sterling’s duty at least to notify WCI also arises under third party beneficiary principles. Whether a contract intends to benefit a third party in any respect is determined by the language of the particular agreement and by the facts and circumstances surrounding it. *Lonsdale v.*

*Chesterfield*, 99 Wn.2d 353, 360-62 (1983). The test is not one of subjective intent or altruistic motive, but whether objectively the language indicates that an obligation to the beneficiary was intended. *Id.* The contract need not identify a specific beneficiary, but may benefit a category of beneficiary. See *id.*

The loan agreement here is titled and referenced throughout as a “Construction Loan Agreement,” and it is for every purpose just that – an agreement exclusively for development of Rita Estates. The Construction Loan Agreement contemplates the Construction Contract and enmeshes Sterling with it. In addition to the explicit assignment and transfer discussed above, the Construction Loan Agreement affords Sterling pervasive rights and powers, including the right to communicate with WCI about construction draws or for “any purpose” (at p2) and to pay WCI directly (at pp3-4), the right to take possession of the site and perform or cause to be performed any of the work if DAD fails to comply with any provisions of the Agreement or if construction ceases “for any reason” (at p4), the right to approve Change Orders (at p6), and the right to stop WCI’s work if Sterling in good faith believes it does not comply with the Construction Loan Agreement or Related Documents or if DAD is in default of any provision (at p6). (See *CP 759-62 & 770-71* for a more detailed summary of the Agreement.)

Given the assignment and transfer, and the other pervasive powers and rights with respect to WCI's contract, WCI was a beneficiary of the Construction Loan Agreement, at least for purposes of entitlement to notice that its construction draws would not be paid by Sterling and that all rights in and to the Construction Contract had been assigned to Sterling.

2. The Summary Judgment Record Supports Various Equitable Remedies.

As stated in *Rummens v. Guaranty Trust Co.*, 199 Wash. 337, 347 (1939),

probably the most important of the equitable maxims [is], namely, that equity will not suffer a wrong (or, as sometimes stated, a right) to be without a remedy...

....

Mere novelty of incident or mere absence of precedent furnishes no sound reason for denying relief when the situation equitably demands it and no principle of law prohibits it. When special circumstances create a situation capable of being redressed within the scope of judicial action, a court of equity will devise a proper remedy, and will not hesitate to do so merely because no relief is provided by rule or precedent.

While WCI requests that this Court do so if determined necessary, WCI submits that the Court need not fashion some novel remedy here. Well-established equitable principles apply under these facts to afford relief.

a. *Estoppel Principles Afford Relief.* WCI's complaints allege estoppel by reason of Sterling's acts and omissions. *CP 29 & 813*

at ¶25 Sterling's motion for summary judgment addressed only "equitable estoppel," arguing that it may not be used offensively. CP 245-46 WCI's response noted that a variety of estoppel principles apply, not just "equitable estoppel." CP 775-78 In response to WCI's motion to amend and clarify the trial court's summary judgment order (CP 924-45) Sterling responded to the merits of WCI's other estoppel bases. CP 946-64 & 965-72 The court entered an amended order clarifying that it intended to dismiss all of WCI's claims based on estoppel or related equitable theories. CP 973-75 In addition to the court's inherent power to fashion appropriate equitable relief, the following traditional estoppel principles afford remedy for WCI.

(1) *Promissory estoppel and estoppel by silence apply under the summary judgment record.*

As stated in *Chemical Bank v. WPPSS*, 102 Wn.2d 874, 901 (1984):

.... American courts, including Washington's, recognize promissory estoppel. It is defined in Restatement (Second) of Contracts 90(1) (1981):

"(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee **or a third person** and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

(Emphasis added to the Restatement quotation.) *Chemical Bank* thus embraced the 1981 Restatement (Second) revision which added reference to a promise expected to induce action by a third person such as WCI. Here, Sterling clearly should have reasonably expected (and did in fact expect) a contractor to perform work in reliance on the Construction Loan Agreement. In addition to the express provisions relating to the Construction Loan Agreement discussed above, Irwin acknowledged that she knew that contractors typically rely on the construction loan for payment of their draws. *CP 395 (Irwin Dep at p91 lines 13-18)* She in fact had a copy of the Construction Contract which stated that adequate financing was an ongoing condition precedent to WCI's performance of the work. WCI clearly changed its position materially in reliance on Sterling's Construction Loan Agreement, Sterling's approved construction budget, and Lisa Irwin's email encouraging Milne to start work. These Sterling documents were shown to Kurt Smith to induce WCI to start work and to continue performance.

Estoppel by silence is related to promissory estoppel. The principle recognizes that sometimes, as here, silence can mislead every bit as much as the spoken word. Estoppel by silence does not require overt action or fraud. As explained in *Central Heat, Inc. v. The Daily Olympian, Inc.*, 74 Wn.2d 126 (1968),

“[P]romissory estoppel . . . is based upon the same equitable principles as is **estoppel by silence**. In the one case a promise is made with the intention that it be acted upon by the promisee; in the other, a person has been silent on some occasion when he should have spoken. But **in either case the party who is estopped has in effect stood by and, in violation of his duty in equity and good conscience to warn another of the real facts, permitted the latter to take some action detrimental to his own interest.**

In order for estoppel to arise in such case **it is not necessary that the one estopped receive some benefit or consideration from the particular transaction; neither is it necessary that he be guilty of some actual overt act of fraud.**

74 Wn.2d at 133 (*quoting Lacy v. Wozencraft*, 188 Okla. 19, 20 (1940), (emphasis added).

(a) Sterling Had a Duty In Equity and Good Conscience to Notify WCI. If the Construction Loan Agreement and assignment and transfer agreement were not alone sufficient to create a duty to disclose the truth to WCI, such a duty to warn of the real facts nonetheless arose “in equity and good conscience.” Sterling argued below that its privacy notice and identical privacy policy prohibited it from notifying WCI, and that Sterling had no legal duty to disclose anything to WCI because WCI was a stranger to the Construction Loan Agreement. Sterling cited no authority for the proposition that DAD had a privacy right to commit fraud. Sterling’s argument fails for any of a number of the reasons discussed below, and fails to overcome the duty created by equity and good conscience here.

(b) Sterling's Privacy Notice Did Not Prohibit Sterling From Notifying WCI That Sterling Would Not Release Funds For WCI's Construction Draws. Sterling relied upon its Privacy Notice issued to Borrowers, which is identical to its "privacy policy," as justification for its failure to notify WCI. *CP 322-23 and CP 337-38* The notice does not even purport to prohibit disclosure to WCI. Indeed, it advises that Sterling

may also disclose Customer Information ... when permitted by law. For example, this may include a disclosure in connection with ... a fraud investigation....

*CP 322* Sterling cites no authority that the law prohibits disclosure under circumstances such as here. Furthermore, notifying WCI that Sterling did not intend to release funds to pay for WCI's work is not the type of disclosure that privacy laws are aimed at. Notice here would involve no unauthorized sale or proprietary use of private customer information. A simple notice that Sterling had not approved WCI's work or would not make payment to WCI would, without anything more, have sufficed to prevent or stop the fraud and demise of WCI.

(c) In any Event, the Construction Loan Agreement Expressly Authorized Disclosure to WCI. Even assuming *arguendo* that the privacy notice prohibited any disclosure without DAD's consent, and that such a notice would legally prohibit disclosure even in the event of the

Borrower's fraud, DAD provided whatever consent may have been required *via* the Construction Loan Agreement itself. As noted *supra*, WCI contends that the Construction Loan Agreement and assignment and transfer provisions actually required notice to WCI. But even if they do not require notice, they certainly authorize disclosure to WCI in any of a number of ways, as well as authorize any of a number of other actions that would have stopped the fraud while amply protecting Sterling's own interests. See *supra* 20-25 and Appendices A & B hereto. For example, if Sterling can contact WCI to discuss draws and "for any purpose," it can certainly tell WCI it will not pay draws. That provision alone permitted Sterling to stop the fraud.

(d) If Negligence Concepts of Duty Were to Apply, the Contract, Sterling's Superior Knowledge, the Unique Circumstances, and Sterling's Partial Disclosure Nonetheless Created a Duty to Notify WCI.

As noted above, "duty" should arise under the equitable doctrines here if disclosure was required "in equity and good conscience" under the totality of the circumstances. Also, with respect to intentional torts, principles of scienter replace the negligence concepts of "duty." See *infra* at 32. That same principle should apply to equitable claims involving knowledge of fraud. But even if the Court were to require a negligence concept of duty for equitable relief here, that duty exists under the record.

First, as noted *supra*, the contract created a duty at least to notify WCI.

Second, a duty arises when one has superior special knowledge of material facts to which another party does not reasonably have access, and the failure to disclose would damage the unaware third party. *Haberman v. WPPSS*, 109 Wn.2d 107, 166-68 (1987), *appeal dismissed*, 488 U.S. 805 (1988); *Amtruck Factors v. International Forest Products*, 59 Wn. App. 8, 16-17 (1990). Here, Sterling not only had special knowledge of material facts to which WCI had no reasonable access, **Sterling created the secret material facts, and then deliberately withheld information about them.** The only reason for the cessation of advances on Rita Estates was Sterling's default decision and demand for immediate payment of over \$10 million on Cook Addition, thereby causing an instantaneous deterioration of the financial condition of Milne and DAD. This was known only to those parties. This is a classic case of superior knowledge.

Third, special circumstances can create a duty that would not otherwise exist. *Tokarz v. Frontier Sav. & Loan Ass'n.*, 33 Wn. App. 456, 461 (1982); *Wells Fargo Bank v. Arizona Laborers*, 201 Ariz. 474, 38 P.3d 12, 22 (2002). Whether a duty exists should be based on all of the circumstances. *Wells Fargo*, 38 P.3d at 35. When a bank has knowledge

of fraud by a customer, that can be a special circumstance creating a duty to disclose. *Id.* at 22.

Finally, Sterling's indication of funding for winter stabilization on Cook Addition and its direct payment to WCI, without disclosure of any problems with either loan agreement, constitutes a partial disclosure that contributed to WCI's perception that Milne's loans were in good standing. One who partially discloses some information has a duty to disclose all material information necessary to prevent a misperception. *Tokarz, supra*, at 461.

Sterling argued below that *Tokarz* supported its proposition that it had no duty to WCI and that disclosure was prohibited. Not so. After noting that special circumstances and superior knowledge can create a duty to disclose, the *Tokarz* court did note further that under the facts there the analysis was complicated by the general rule that a bank is under a duty not to disclose the financial condition of its customers. *33 Wn. App. at 461* However, the court proceeded to "weigh the bank's general duty not to disclose information about a customer against the duty to disclose which may arise under special circumstances." *Id.* *Tokarz* therefore does not hold that disclosure was prohibited, but rather calls for a weighing process even when a bank arguably otherwise has a duty not to disclose.

Here, the “complication” noted in *Tokarz* does not even arise and no such balancing is necessary. None of the authorities cited for the “general rule” that a bank may not disclose the financial condition of its customer deal with situations when, as here, disclosure is required to prevent a fraud on and the financial demise of a known victim, the disclosure could be a simple notice to one victim that the bank does not intend to pay its draw requests, the bank derived a significant benefit by withholding disclosure, and, in any event, the bank customer expressly authorized disclosure in its loan agreement.

Second, the *Tokarz* court took care to note that there the bank derived no special benefit, and there was no evidence that the bank was negligent in making the loan (the plaintiff offered no evidence at all in opposition to the summary judgment motion), so the court found no special circumstances. Here, there is evidence of knowledge of the fraud, knowing benefit therefrom, and negligence. These are special circumstances.

Third, the *Tokarz* court concluded that if disclosure were required under the facts there, it “would impose an awesome burden on lenders to notify all of their customers whenever a contractor had difficulties.”<sup>11</sup> *Id.*

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<sup>11</sup> The situation in *Tokarz* was quite different than here. *Tokarz* contracted with Post to build a house, and obtained the construction loan from Frontier. Frontier had loaned money to Post for construction of five homes. A month after the *Tokarz* loan, a routine

at 462. No burden would be created by recognizing a duty to disclose to WCI here. The disclosure would be to one known victim of the fraud -- a victim who Sterling knew was relying on Sterling for payment. No investigation was required, either.

Finally, even if this Court were to weigh a “general rule” of non-disclosure of a customer’s financial information against the circumstances here, the scale would tip heavily in WCI’s favor. A simple notice to WCI would have prevented fraud and financial devastation of a contractor, without burden on or harm to the lender. Allowing the fraud to proceed served no public benefit whatsoever.

Thus, whether or not a negligence concept of duty were applied here, promissory estoppel and estoppel by silence are viable remedies under the record. These estoppel principles would put the parties in the same positions they should have expected to be in upon performance of WCI’s work. Under the Construction Loan Agreement, any payment by Sterling for WCI work becomes an advance under the Construction Loan Agreement, becomes an obligation of the Borrower and Guarantors to

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credit report by Frontier disclosed five liens on the other homes being built by Post, and four months after that Frontier discontinued making loans to Post. Frontier made advances to Tokarz under his loan, until Tokarz became dissatisfied with Post and ordered him off the job. Tokarz sued Frontier, alleging that it knew or should have known of Post’s financial problems and inability to perform other projects. There was no evidence that Frontier knew of any Post problems at the time of the Tokarz loan, and Frontier’s credit report was not considered detrimental to Post’s credit. The liens were explainable.

Sterling, and is secured by Sterling's Deed of Trust. As contemplated, WCI would get paid for its work, and Sterling would have rights secured by the improved property to be repaid for its loan advances from its Borrower and Guarantors, all of which Sterling found sufficient for purposes of granting the project loan. Sterling had any of a number of avenues available to it to avoid any expense for construction, if that were its desire, while still treating WCI fairly. Instead, Sterling chose to remain silent and accept the benefits of WCI's work.

The record further evidences that Sterling was imprudent in granting and administering the loans here. See *supra* and CP 763-67. But even if Sterling were purely innocent, as between two innocent parties the one who made the fraud possible should bear the loss. Sterling should therefore be estopped from refusing to pay for WCI's work under the doctrines of promissory estoppel and estoppel by silence.

*(2) Principles of Equitable Estoppel, Estoppel In Pais, Estoppel by Acquiescence and Equitable Subrogation or Subordination Can Be Extended Under the Record.*

Equitable estoppel requires: 1) conduct inconsistent with a claim afterward asserted; 2) reliance thereon by another; and 3) injury if the prior acts are contradicted or repudiated. *Colonial Imports, Inc. v. Carlton Northwest, Inc.*, 121 Wn.2d 726, 734 (1993) While Sterling relies on the general premise that equitable estoppel is available only defensively, that

general rule is riddled with exceptions and has not been applied consistently. See the Supreme Court's discussion in *Chemical Bank v. WPPSS*, *supra*, 102 Wn.2d at 902. Estoppel in pais, which is sometimes equated with equitable estoppel, has the same basic elements (*see, e.g., Business Factors v. Taylor-Edwards*, 21 Wn. App. 441, 449 (1978)), and both equitable estoppel and estoppel in pais are used affirmatively. *See, e.g., Safeco v. Butler*, 118 Wn.2d 383, 393 (1992)(estoppel to prevent insurers who act in bad faith from asserting policy defenses); *Lamm v. McTighe*, 72 Wn.2d 587, 591 (1967)(estoppel to adjust boundary lines); *Central Heat, Inc. v. The Daily Olympian, Inc.*, *supra*, 74 Wn.2d at 134 (estoppel to prevent statute of limitations defense). Moreover, in *Colonial Imports, Inc.*, 121 Wn.2d at 735, the Supreme Court allowed the plaintiff to use equitable estoppel to support a claim for contract damages, stating that equitable estoppel "has the effect of precluding one party from offering an explanation or defense that he or she would otherwise be able to assert." Sterling should therefore be equitably estopped from asserting a defense to payment based on its undisclosed cessation of advances. Unless there is only one permissible inference from the facts, equitable estoppel is an issue for the jury. *Id.* at 737

Alternatively,

As effecting title to land, equitable estoppel is a doctrine by which a party may be prevented from setting up his legal title because he has through his acts, words, or silence led another to take a position in which the assertion of the legal title would be contrary to equity and good conscience.

*Sorenson v. Pyeatt*, 158 Wn.2d 523, 539 (2006). If equitable estoppel and estoppel in pais can be used to defeat or adjust title, the principles underlying these doctrines should allow the court to equitably defeat or adjust security interests in the property. Sterling should be equitably estopped from asserting lien priority over WCI's lien.

Equitable subordination or subrogation is another doctrine that could estop Sterling from asserting lien priority over WCI. The doctrine is intended to apply justice when standard lien priorities would not. It "is fundamentally an equitable concept designed 'to impose ultimate responsibility for a wrong on the party who, in equity and good conscience, ought to bear it.'" *Kim v. Lee*, 145 Wn.2d 79, 88 (2001), quoting *Mahler v. Szucs*, 135 Wn.2d 398, 411 (1998). The doctrine "is not a fixed rule of law or of equity..." and is always liberally allowed in the interests of justice and equity. *Id.* After referring to four commonly referenced situations in which the doctrine has been applied, the Court in *Tri-City Construction Council, Inc. v. Westfall*, 127 Wn. App. 669, 675 (2005) took care to note that these are "generally recognized categories," but "there is no defined rule," explaining that the doctrine is founded on

“[p]rinciples of natural justice.” Most recently the Supreme Court in *Bank of America v. Prestance Corporation*, 160 Wn. 2d 560 (2007) described evolution of the doctrine as follows:

Despite an initial resistance to equitable subrogation, many courts now apply it liberally. *See Martin v. Hickenlooper*, 90 Utah 150, 161, 59 P.2d 1139, 1144 (1936) ("It will be seen that the more recent cases show a very decided liberality over the stricter cases of a generation ago."). This language from an Arkansas Supreme Court opinion, applying subrogation freely with regard to "perfect justice" instead of unnecessary rules, is typical:

"The doctrine of subrogation is an equitable one, having for its basis the doing of complete and perfect justice between the parties without regard to form, and its purpose and object is the prevention of injustice. . . .

"It rests upon the maxim that no one shall be enriched by another's loss, and may be invoked wherever justice and good conscience demand its application in opposition to the technical rules of law, which liberate securities with the extinguishment of the original debt. . . .

*Cox v. Wooten Bros. Farms, Inc.*, 271 Ark. 735, 737-38, 610 S.W.2d 278, 280 (1981) (quoting *Baker v. Leigh*, 238 Ark. 918, 923-24, 385 S.W.2d 790, 794 (1965)); *see also Home Sav. Bank v. Bierstadt*, 168 Ill. 618, 48 N.E. 161, 162 (1897) ("[Equitable subrogation] has been steadily expanding and growing in importance and extent in its application to various subjects and classes of persons. This equitable principle is enforced solely for the accomplishment of substantial justice where one has an equity to invoke which cannot injure an innocent person.").

Estoppel and subrogation principles therefore allow the court to subordinate Sterling's lien.

b. *Unjust Enrichment Principles Afford Relief.*

A recipient of a benefit will be required to pay for it if under the circumstances it would be unjust to allow him to retain the benefit without paying. *Irwin Concrete v. Sun Coast Properties*, 33 Wn. App. 190, 193-94 (1982). A benefit includes any form of advantage. *Id.* The determination of what is unjust is very fact-specific to each circumstance.

Washington courts recognize that unjust enrichment is a remedy available to a contractor against a construction lender. In *Irwin Concrete*, for example, five subcontractor/engineer lien claimants whose liens against the project were extinguished by the lender's Trustee's sale nonetheless recovered the value of their work on the project from the lender on an unjust enrichment basis. In *Town Concrete Pipe v. Redford*, 43 Wn. App. 493 (1986), the Court likewise concluded that a contractor could have a claim for unjust enrichment against the construction lender, notwithstanding the adoption of the lender notice provision in the lien statutes. In *Town Concrete*, the Court found that the benefit conferred by the contractor was not unjust, however, because there (unlike in *Irwin Concrete* and here) the lender had already paid the borrower the amount earmarked for the contractor's work. The lender should not be required to pay a second time for the same benefit.

Some jurisdictions have applied unjust enrichment or analogous concepts to allow a contractor to recover from the lender whenever the contractor has relied upon the loan agreement and the lender has made no payment to the borrower for the work. See, e.g., equitable lien cases such as *Blosam Contractors v. Republic Mortgage Investors*, 353 So.2d 1225 (Fla. 1977) and *Embree Construction Group, Inc. v. Rafcor, Inc.*, 330 N.C. 487, 492-97, 411 S.E. 2d 916, 921-23 (1992); and *Swinderton & Walberg Co. v. Union Bank*, 25 Cal. App. 3d 259, 263-66, 101 Cal. Rptr. 665 (1972)(“When the lender has received the benefit of the claimant’s performance, and therefore a more valuable security for its note, it is not justified in withholding or appropriating to any other use money intended to be used to pay for such performance and relied upon by the claimant in rendering its performance.” *Miller v. Mountain View Sav. & Loan Assn.*, 238 Cal. App. 2d 664, 661[1965]....” )<sup>12</sup> Other jurisdictions are split on when and how unjust enrichment or other equitable remedies may apply. See the detailed discussion in *Embree Construction Group, Inc., supra*, and cases discussed therein.

We submit that the reasoning of those cases finding a remedy for the unpaid contractors are more consistent with *Irwin Concrete*, and they better serve equity and the public interest. Should this Court so desire,

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<sup>12</sup> California has since adopted an exclusive statutory procedure. Per *Town Concrete*, Washington’s stop notice procedure does not exclude equitable relief.

however, it need not decide here whether recovery should be available whenever the lender has not paid for the contractor's betterment to the lender's security. Here, the lender's knowledge of the borrower's fraud and its substantial benefit from it, and the assignment and transfer of all rights in and to the construction contract and other pervasive loan provisions, distinguish our circumstances and make the case for relief more compelling.

The issue of unjust enrichment is one for the jury. *Auburn Mechanical v. Lydig Construction*, 89 Wn. App. 893 (1998).

3. WCI Has Legally Viable Claims for Aiding and Abetting a Fraud and Tortious Interference With Contract.

a. *The Partial Denial of WCI's Motion to Amend Was Erroneous.*

The trial court granted WCI's motion to amend to allow a tortious interference with contract claim, but denied leave to add an aiding and abetting and other WCI claim theories.<sup>13</sup> WCI respectfully submits that the trial court committed legal error or abused its discretion by denying leave with respect to WCI's additional claims.

The trial court's decision on a motion to amend is reviewed for abuse of discretion. *Herron v. Tribune Publishing Co.*, 108 Wn.2d 162,

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<sup>13</sup> Leave to assert WCI's proposed claims for negligent misrepresentation and negligent administration of the loan agreement were also denied. Much of the focus of argument below was on the proposed personal injury claims of Kurt Smith. Kurt Smith is not appealing the decision with respect to his claims.

165 (1987). Whether the trial court committed legal error should be reviewed de novo, and if the decision was based on legal error it constitutes abuse of discretion. See *Denny's v. Security Union Title Ins.*, 71 Wn. App. 194, 212-13 (1993); see also *Activate Inc.*, *supra*, 150 Wn. App. at 812 (all questions of law are reviewed de novo).

Amendment “shall be freely granted when justice so requires.” *CR 15(a)*. Leave should be granted unless amendment would be futile or the defendant demonstrates undue prejudice. When, as here, the new claims arise out of the same circumstances as the existing complaint, leave should be more freely granted. *Herron*, *supra*. Denial in the absence of demonstrated prejudice is an abuse of discretion. See *Tagliani v. Colwell*, *supra*, 10 Wn. App. at 233 (finding abuse of discretion even when the motion was made after oral ruling on summary judgment).

(1) *Aiding and Abetting a Fraud Is a Viable Claim and Amendment Was Not Futile.* Sterling contended below that Washington does not recognize an aiding and abetting a claim. It is, however, a well-recognized claim basis, and we submit that Washington has already, and in any event should, recognize such a claim. The Restatement (Second) of Torts §876 outlines an aiding and abetting liability as follows:

For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he...(b) knows that the other's

conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself...

In *Wells Fargo Bank v. Arizona Laborers, supra*, 38 P.3d at 21-28, the court engaged in a thorough discussion of aiding and abetting a fraud liability, noting the Restatement (Second) of Torts § 876. The *Wells Fargo* court further explained that in aiding and abetting fraud cases, negligence concepts of “duty to disclose” are replaced with a “scienter” element (*i.e.*, knowledge of the alleged fraud). 38 P.2d at 21-22 & 23 Knowledge of the fraud may be inferred by the circumstances. *Id.* A banker’s knowledge of its customer’s fraud can also constitute a “special circumstance” giving rise to duty to notify. *Id.* at 22.

Washington has recognized aiding and abetting a tort and has embraced § 876 of the Restatement. For example, in *Davin v. Dowling*, 146 Wash. 137, 138-40 (1927) the Supreme Court held that a bank was liable for aiding and abetting a conversion by a third party when the tortfeasor would have been unable to make a purchase without the consent and cooperation of the bank, stating that “where one aids and assists in a wrongful taking of chattels, he is liable for conversion, the same as the active participants.” (Citation omitted). In *Thomas v. Casey*, 49 Wn.2d 14, 17-18 (1956) the Supreme Court considered a jury instruction based on § 876 and stated:

Subsection (b) seems clearly to apply to the present case; Foster knew that the conduct of Casey and Callahan was negligent and a breach of duty to other users of the highway, and, if he did not give substantial assistance, his conduct certainly gave them encouragement to proceed as they were doing. That he did not speak words of encouragement may be conceded, but he said nothing to discourage them; a situation existed where actions speak louder than words. His failure to object or to prohibit the doing of an obviously negligent and unlawful act was tacit approval and encouragement to Casey and Callahan to continue their negligent and unlawful course of conduct.

49 Wn.2d at 18. The Court went on to find that aiding and abetting liability was not necessary, as there was a basis for direct liability. In *Westview Invs. Ltd v. U.S. Bank*, 133 Wn. App. 835, 853-54 (2006) the Court quoted § 876 as setting forth the elements of a concerted action claim. And in *Martin v. Abbott Laboratories*, 102 Wn.2d 581, 596 (1984), the Supreme Court applied Restatement § 876 in concluding that under the facts there a concerted action claim had not been proven.<sup>14</sup>

If this Court determines that Washington has not recognized aiding and abetting a fraud liability, WCI requests that the Court do so now. It is accepted in numerous jurisdictions. See the cases cited in the thorough discussion of the law in *Wells Fargo Bank v. Arizona Laborers, supra*, and the discussion and cases cited in *Adelphia Recovery Trust v. Bank of*

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<sup>14</sup>The Court was confronted with “concerted action” claims against various drug manufacturers by plaintiffs allegedly injured by the drug DES, even though they could not identify the manufacturer who made the drug ingested. 102 Wn.2d at 583. The Court quoted § 876 and proceeded to discuss whether the manufacturers could be liable for concerted action under it. The Court concluded that parallel and imitative action among multiple manufacturers was not sufficient for “concerted action.”

*America*, 624 F. Supp. 2d 292, 308-12 (S.D.N.Y. 2009) (finding that Pennsylvania would recognize the tort, and citing to other federal cases finding that aiding and abetting a fraud is broadly recognized and that the applicable states would recognize the tort). See also *Dale v. Ala Acquisitions, Inc.*, 2003 F. Supp. 2d 694, 700 (2002)(citing to 28 jurisdictions that have adopted aiding and abetting liability); *El Camino Resources, Ltd. v. Huntington National Bank*, 2009 U.S. Dist. Lexis 13143 (W.D. MI 2009)(requisite intent may be shown by circumstantial evidence and is flexible, depending on the specific circumstances of the case); & *Diodati v. Brown, Todd & Heyburn*, 693 F. Supp. 1259, 1264 (D. MA 1988)(“intent” is satisfied if the defendant knew or should have known of the fraud).

WCI respectfully requests that this Court adopt the analysis in *Wells Fargo* and join the numerous other jurisdictions in recognizing aiding and abetting fraud liability.

(2) *Sterling Did Not Demonstrate That Amendment Would Cause Undue Prejudice.*

Sterling failed to show any prejudice with respect to the additional WCI claim theories. It argued that it would be “prejudiced” by having to defend a claim basis that does not exist in Washington, and that introducing a “sensational sounding claim” would distract and confuse the

jury. The jury, however, is not “distracted” when it is asked to do justice by finding a defendant liable under a legally viable and proven claim. Nor would the claims “confuse” the jury. As noted *supra*, the underlying fraud, Sterling’s knowledge of it, assistance and knowing benefit from it, were part of this suit from the outset and underpin WCI’s equitable claims. “If the underlying facts or circumstances relied upon by a plaintiff may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits.” *Tagliani, supra*, 10 Wn. App. at 233, quoting *Foman v. Davis*, 371 U.S. 178, 182 (1962). The trial court allowed amendment to assert tortious interference with contract, also based on the same facts. As of the time WCI filed its motion, Sterling had not taken any depositions, discovery had not closed, and no additional discovery or witnesses would have been required if aiding and abetting were permitted.

*b. The Summary Judgment Record Supports the Claim for Aiding and Abetting the Milne Fraud.*

The aiding and abetting claim was not only legally viable, the facts alleged in the complaint were well supported in the summary judgment record. The underlying fraud is not contested, the evidence supports a finding that Sterling knew of it, the fraud could not have occurred without Sterling’s silence, and Sterling knowingly benefitted from its deliberate silence in multiple ways.

c. *The Summary Judgment Record Supports the Claim for Tortious Interference With Contract.*

The elements necessary to make a claim for tortious interference are: 1) the existence of a valid contractual relationship; 2) defendant's knowledge of that relationship; 3) an intentional interference inducing or causing a breach or termination of the relationship; 4) defendant's interference for an improper purpose or using improper means; and 5) resultant damages. *Pleas v. City of Seattle*, 112 Wn.2d 794, 800-06 (1989). All five elements are satisfied here. WCI had a valid contract, and Sterling knew of it. Sterling intended the actions which caused the interference, knowing WCI was relying on the loan funds from Sterling for payment and that adequate financing was a condition precedent for WCI's ongoing work. Intent to interfere does not require an intent to do harm – the "intent" element is satisfied if the actor knows the harm is substantially certain to occur as a result of its action. *Newton Ins. Agency & Brokerage, Inc. v. Caledonian Ins. Group, Inc.*, 114 Wn. App. 151, 158 (2002).

The record would also support a jury finding of "improper means or methods" or "improper purpose." Improper means or methods and improper purpose are typically jury issues. *Newton Ins. Agency, supra*, at 159. Improper means or methods can create liability even in the absence

of improper purpose and even if the defendant has a privilege defense to improper purpose. *Pleas v. City of Seattle*, at 804. Here, the jury could well find that Sterling's deliberate failure to give WCI any notice or warning, while knowingly deriving a benefit from WCI's substantial effort and expense, was improper means or method. Moreover, the termination of all DAD's rights in and to the Construction Contract and termination of rights even to use the Project Documents required for compliance with the Construction Contract, without any notice whatsoever to WCI, was improper means and methods.

Likewise, the jury could also find that Sterling intended to withhold funds and remain silent in order to obtain WCI's valuable performance without having to pay for it. Sterling paid for the work necessary to protect Cook Addition where no contractor was working, but obtained that benefit on Rita Estates without cost by allowing WCI to continue to work. Remaining silent to obtain a benefit at WCI's expense would be improper purpose. Sterling's defenses of good faith business practice, if not overcome by improper means, are defenses it has the burden of establishing before the jury.

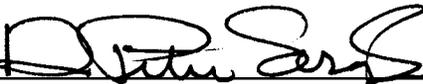
Finally, WCI was clearly damaged by the interference. Tortious interference was supported by the record, and WCI should have the opportunity to present its claim to a jury.

**F. CONCLUSION**

The record and reasonable inferences therefrom demonstrate material issues of fact for all of WCI's claims against Sterling. WCI therefore requests that the Court reverse the summary judgment ruling and denials of leave to amend, and remand for trial of all claims consistently with this Court's ruling.

RESPECTFULLY SUBMITTED this 22<sup>nd</sup> day of February, 2009.

SORG PLLC

By   
H. Peter Sorg, Jr. WSBA #9149  
Attorney for Appellant WCI

**APPENDIX A**

**RITA ESTATES CONSTRUCTION LOAN AGREEMENT  
(WITH COUNSEL'S NOTATIONS)**

Exhibit 10  
 Witness FRWD  
 Date 3/23/09  
 Buell Realtime Reporting  
 (206) 287-9066

**CONSTRUCTION LOAN AGREEMENT**

Principal	Loan Date	Maturity	Loan No	Coll Coll	Account	Officer	Initials
\$3,050,000.00	11-05-2007	12-01-2008	1579000125	118		LAJ	

References in the boxes above are for Lender's use only and do not limit the applicability of this document to any particular loan or item. Any item above containing \*\*\*\*\* has been omitted due to text length limitations.

**Borrower:** David Alan Development, LLC  
 914 164th St SE #12  
 Mill Creek, WA 98012

**Lender:** Sterling Savings Bank  
 Bellevue Construction Lending  
 Action Mortgage Company  
 11400 SE 8th Street Suite 110  
 Bellevue, WA 98004-6431

THIS CONSTRUCTION LOAN AGREEMENT dated November 5, 2007, is made and executed between David Alan Development, LLC ("Borrower") and Sterling Savings Bank ("Lender") on the following terms and conditions. Borrower has applied to Lender for one or more loans for purposes of constructing the Improvements on the Real Property described below. Lender is willing to lend the loan amount to Borrower solely under the terms and conditions specified in this Agreement and in the Related Documents, to each of which Borrower agrees. Borrower understands and agrees that: (A) in granting, renewing, or extending any Loan, Lender is relying upon Borrower's representations, warranties, and agreements as set forth in this Agreement, and (B) all such Loans shall be and remain subject to the terms and conditions of this Agreement.

**TERM.** This Agreement shall be effective as of November 5, 2007, and shall continue in full force and effect until such time as all of Borrower's Loans in favor of Lender have been paid in full, including principal, interest, costs, expenses, attorneys' fees, and other fees and charges, or until December 1, 2008.

**ADVANCE AUTHORITY.** The following person or persons are authorized to request advances and authorize payments under the line of credit until Lender receives from Borrower, at Lender's address shown above, written notice of revocation of such authority: David Alan Milne, Manager of David Alan Development, LLC; and /or assigns.

**LOAN.** The Loan shall be in an amount not to exceed the principal sum of U.S. \$3,050,000.00 and shall bear interest on so much of the principal sum as shall be advanced pursuant to the terms of this Agreement and the Related Documents. The Loan shall bear interest on each Advance from the date of the Advance in accordance with the terms of the Note. Borrower shall use the Loan Funds solely for the payment of: (A) the costs of constructing the Improvements and equipping the Project in accordance with the Construction Contract; (B) other costs and expenses incurred or to be incurred in connection with the construction of the Improvements as Lender in its sole discretion shall approve; and (C) if permitted by Lender, interest due under the Note, including all expenses and all loan and commitment fees described in this Agreement. The Loan amount shall be subject at all times to all maximum limits and conditions set forth in this Agreement or in any of the Related Documents, including without limitation, any limits relating to loan to value ratios and acquisition and Project costs.

**PROJECT DESCRIPTION.** The word "Project" as used in this Agreement means the construction and completion of all Improvements contemplated by this Agreement, including without limitation the erection of the building or structure on the Real Property identified to this Agreement by Borrower and Lender, installation of equipment and fixtures, landscaping, and all other work necessary to make the Project usable and complete for the intended purposes. The Project includes the following work:

**A&D LOAN.**

The word "Property" as used in this Agreement means the Real Property together with all Improvements, all equipment, fixtures, and other articles of personal property now or subsequently attached or affixed to the Real Property, together with all accessions, parts, and additions to, all replacements of, and all substitutions for any of such property, and all proceeds (including insurance proceeds and refunds of premiums) from any sale or other disposition of such property. The real estate described below constitutes the Real Property as used in this Agreement.

**The real estate legally described as:**

THAT PORTION OF THE SOUTHWEST QUARTER OF THE NORTHEAST QUARTER OF SECTION 25, TOWNSHIP 22 NORTH, RANGE 1 EAST, W.M., IN PIERCE COUNTY, WASHINGTON, LYING WESTERLY OF GIG HARBOR-PURDY COUNTY ROAD;

EXCEPT PORTION CONVEYED TO THE STATE OF WASHINGTON FOR STATE ROUTE NO. 16 AND STATE HIGHWAY NO. 14.

**Its address is commonly known as:**

Real Property located at Ptn. SW1/4, NE1/4, 25-22-01, Gig Harbor, WA.

**FEES AND EXPENSES.** As a condition of Lender making the Loan, Borrower agrees to pay the following fees, charges, and expenses, in addition to all others set forth in this Agreement: **Closing Costs.** Whether or not the Project shall be consummated, Borrower shall assume and pay upon demand all out-of-pocket expenses incurred by Lender in connection with the preparation of loan documents and the making of the Loan, including without limitation the following: (A) all closing costs, loan fees, and disbursements; (B) all expenses of Lender's legal counsel; and (C) all title examination fees, title insurance premiums, appraisal fees, survey costs, required fees, and filing and recording fees.

**NO CONSTRUCTION PRIOR TO RECORDING OF SECURITY DOCUMENT.** Borrower will not permit any work or materials to be furnished in connection with the Project until (A) Borrower has signed the Related Documents; (B) Lender's mortgage or deed of trust and other Security Interests in the Property have been duly recorded and perfected; (C) Lender has been provided evidence, satisfactory to Lender, that Borrower has obtained all insurance required under this Agreement or any Related Documents and that Lender's liens on the Property and Improvements are valid perfected first liens, subject only to such exceptions, if any, acceptable to Lender.

**REPRESENTATIONS AND WARRANTIES.** Borrower represents and warrants to Lender, as of the date of this Agreement, as of the date of each disbursement of loan proceeds, as of the date of any renewal, extension or modification of any Loan, and at all times any indebtedness exists:

**Organization.** Borrower is a limited liability company which is, and at all times shall be, duly organized, validly existing, and in good standing under and by virtue of the laws of the State of Arizona. Borrower is duly authorized to transact business in the State of Washington and all other states in which Borrower is doing business, having obtained all necessary filings, governmental licenses and approvals for each state in which Borrower is doing business. Specifically, Borrower is, and at all times shall be, duly qualified as a foreign limited liability company in all states in which the failure to so qualify would have a material adverse effect on its business or financial condition. Borrower has the full power and authority to own its properties and to transact the business in which it is presently engaged or presently proposes to engage. Borrower maintains an office at 914 164th St SE #12, Mill Creek, WA 98012. Unless Borrower has designated otherwise in writing, the principal office is the office at which Borrower keeps its books and records including its records concerning the Collateral. Borrower will notify Lender prior to any change in the location of Borrower's state of organization or any change in Borrower's name. Borrower shall do all things necessary to preserve and to keep in full force and effect its existence, rights and privileges, and shall comply with all regulations, rules, ordinances, statutes, orders and decrees of any governmental or quasi-governmental authority or court applicable to Borrower and Borrower's business activities.

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CONSTRUCTION LOAN AGREEMENT  
(Continued)

**Assumed Business Names.** Borrower has filed or recorded all documents or filings required by law relating to all assumed business names used by Borrower. Excluding the name of Borrower, the following is a complete list of all assumed business names under which Borrower does business: None.

**Authorization.** Borrower's execution, delivery, and performance of this Agreement and all the Related Documents have been duly authorized by all necessary action by Borrower and do not conflict with, result in a violation of, or constitute a default under (1) any provision of (a) Borrower's articles of organization or membership agreements, or (b) any agreement or other instrument binding upon Borrower or (2) any law, governmental regulation, court decree, or order applicable to Borrower or to Borrower's properties.

**Financial Information.** Each of Borrower's financial statements supplied to Lender truly and completely disclosed Borrower's financial condition as of the date of the statement, and there has been no material adverse change in Borrower's financial condition subsequent to the date of the most recent financial statement supplied to Lender. Borrower has no material contingent obligations except as disclosed in such financial statements.

**Legal Effect.** This Agreement constitutes, and any instrument or agreement Borrower is required to give under this Agreement when delivered will constitute legal, valid, and binding obligations of Borrower enforceable against Borrower in accordance with their respective terms.

**Properties.** Except as contemplated by this Agreement or as previously disclosed in Borrower's financial statements or in writing to Lender and as accepted by Lender, and except for property tax liens for taxes not presently due and payable, Borrower owns and has good title to all of Borrower's properties free and clear of all Security Interests, and has not executed any security documents or financing statements relating to such properties. All of Borrower's properties are titled in Borrower's legal name, and Borrower has not used or filed a financing statement under any other name for at least the last five (5) years.

**Litigation and Claims.** No litigation, claim, investigation, administrative proceeding or similar action (including those for unpaid taxes) against Borrower is pending or threatened, and no other event has occurred which may materially adversely affect Borrower's financial condition or properties, other than litigation, claims, or other events, if any, that have been disclosed to and acknowledged by Lender in writing.

**Taxes.** To the best of Borrower's knowledge, all of Borrower's tax returns and reports that are or were required to be filed, have been filed, and all taxes, assessments and other governmental charges have been paid in full, except those presently being or to be contested by Borrower in good faith in the ordinary course of business and for which adequate reserves have been provided.

**Lien Priority.** Unless otherwise previously disclosed to Lender in writing, Borrower has not entered into or granted any Security Agreements, or permitted the filing or attachment of any Security Interests on or affecting any of the Collateral directly or indirectly securing repayment of Borrower's Loan and Note, that would be prior or that may in any way be superior to Lender's Security Interests and rights in and to such Collateral.

**Binding Effect.** This Agreement, the Note, all Security Agreements (if any), and all Related Documents are binding upon the signers thereof, as well as upon their successors, representatives and assigns, and are legally enforceable in accordance with their respective terms.

**Title to Property.** Borrower has, or on the date of first disbursement of Loan proceeds will have, good and marketable title to the Collateral free and clear of all defects, liens, and encumbrances, excepting only liens for taxes, assessments, or governmental charges or levies not yet delinquent or payable without penalty or interest, and such liens and encumbrances as may be approved in writing by the Lender. The Collateral is contiguous to publicly dedicated streets, roads, or highways providing access to the Collateral.

**Project Costs.** The Project costs are true and accurate estimates of the costs necessary to complete the Improvements in a good and workmanlike manner according to the Plans and Specifications presented by Borrower to Lender, and Borrower shall take all steps necessary to prevent the actual cost of the Improvements from exceeding the Project costs.

**Utility Services.** All utility services appropriate to the use of the Project after completion of construction are available at the boundaries of the Collateral.

**Assessment of Property.** The Collateral is and will continue to be assessed and taxed as an independent parcel by all governmental authorities.

**Compliance with Governing Authorities.** Borrower has examined and is familiar with all the easements, covenants, conditions, restrictions, reservations, building laws, regulations, zoning ordinances, and federal, state, and local requirements affecting the Project. The Project will at all times and in all respects conform to and comply with the requirements of such easements, covenants, conditions, restrictions, reservations, building laws, regulations, zoning ordinances, and federal, state, and local requirements.

**Survival of Representations and Warranties.** Borrower understands and agrees that in extending Loan Advances, Lender is relying on all representations, warranties, and covenants made by Borrower in this Agreement or in any certificate or other instrument delivered by Borrower to Lender under this Agreement or the Related Documents. Borrower further agrees that regardless of any investigation made by Lender, all such representations, warranties and covenants will survive the extension of Loan Advances and delivery to Lender of the Related Documents, shall be continuing in nature, shall be deemed made and redated by Borrower at the time each Loan Advance is made, and shall remain in full force and effect until such time as Borrower's indebtedness shall be paid in full, or until this Agreement shall be terminated in the manner provided above, whichever is the last to occur.

**CONDITIONS PRECEDENT TO EACH ADVANCE.** Lender's obligation to make the initial Advance and each subsequent Advance under this Agreement shall be subject to the fulfillment to Lender's satisfaction of all of the conditions set forth in this Agreement and in the Related Documents, *as requested by Lender,*

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**Approval of Contractors, Subcontractors, and Materialmen.** Lender shall have approved a list of all contractors employed in connection with the construction of the Improvements, showing the name, address, and telephone number of each contractor, a general description of the nature of the work to be done, the labor and materials to be supplied, the names of materialmen, if known, and the approximate dollar value of the labor, work, or materials with respect to each contractor or materialman. Lender shall have the right to communicate with any person to verify the facts disclosed by the list or by any application for any Advance, or for any other purpose.

**Plans, Specifications, and Permits.** Lender shall have received and accepted a complete set of written Plans and Specifications setting forth all Improvements for the Project, and Borrower shall have furnished to Lender copies of all permits and requisite approvals of any governmental body necessary for the construction and use of the Project.

**Architect's and Construction Contracts.** Borrower shall have furnished in form and substance satisfactory to Lender an executed copy of the Architect's Contract and an executed copy of the Construction Contract.

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CP 792

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 3

**Budget and Schedule of Estimated Advances.** Lender shall have approved detailed budget and cash flow projections of total Project costs and a schedule of the estimated amount and time of disbursements of each Advance.

**Borrower's Authorization.** Borrower shall have provided in form and substance satisfactory to Lender properly certified resolutions, duly authorizing the consummation of the Project and duly authorizing the execution and delivery of this Agreement, the Note and the Related Documents. In addition, Borrower shall have provided such other resolutions, authorizations, documents and instruments as Lender or its counsel, in their sole discretion, may require.

**Bond.** If requested by Lender, Borrower shall have furnished a performance and payment bond in an amount equal to 100% of the amount of the Construction Contract, as well as a materialmen's and mechanics' payment bond, with such riders and supplements as Lender may require, each in form and substance satisfactory to Lender, naming the General Contractor as principal and Lender as an additional obligee.

**Appraisal.** If required by Lender, an appraisal shall be prepared for the Property, at Borrower's expense, which in form and substance shall be satisfactory to Lender, in Lender's sole discretion, including applicable regulatory requirements.

**Plans and Specifications.** If requested by Lender, Borrower shall have assigned to Lender on Lender's forms the Plans and Specifications for the Project.

**Environmental Report.** If requested by Lender, Borrower shall have furnished to Lender, at Borrower's expense, an environmental report and certificate on the Property in form and substance satisfactory to Lender, prepared by an engineer or other expert satisfactory to Lender stating that the Property complies with all applicable provisions and requirements of the "Hazardous Substances" paragraph set forth in this Agreement.

**Soil Report.** If requested by Lender, Borrower shall have furnished to Lender, at Borrower's expenses, a soil report for the Property in form and substance satisfactory to Lender, prepared by a registered engineer satisfactory to Lender stating that the Property is free from soil or other geological conditions that would preclude its use or development as contemplated without extra expense for precautionary, corrective or remedial measures.

**Survey.** If requested by Lender, Borrower shall have furnished to Lender a survey of recent date, prepared and certified by a qualified surveyor and providing that the Improvements, if constructed in accordance with the Plans and Specifications, shall lie wholly within the boundaries of the Collateral without encroachment or violation of any zoning ordinances, building codes or regulations, or setback requirements, together with such other information as Lender in its sole discretion may require.

**Zoning.** Borrower shall have furnished evidence satisfactory to Lender that the Collateral is duly and validly zoned for the construction, maintenance, and operation of the Project.

**Title Insurance.** Borrower shall have provided to Lender an ALTA Lender's extended coverage policy of title insurance with such endorsements as Lender may require, issued by a title insurance company acceptable to Lender and in a form, amount, and content satisfactory to Lender, insuring or agreeing to insure that Lender's security agreement or other security document on the Property is or will be upon recordation a valid first lien on the Property free and clear of all defects, liens, encumbrances, and exceptions except those as specifically accepted by Lender in writing. If requested by Lender, Borrower shall provide to Lender, at Borrower's expense, a foundation endorsement to the title policy upon the completion of each foundation for the Improvements, showing no encroachments, and upon completion an endorsement which insures the lien-free completion of the Improvements. Specifically, Borrower shall provide to Lender the following title insurance endorsements: 100-ALTA, 8.1-ENVIRONMENTAL PROTECTION, 6.0-VARIABLE RATE.

**Insurance.** Unless waived by Lender in writing, Borrower shall have delivered to Lender the following insurance policies or evidence thereof: (a) an all risks course of construction insurance policy (builder's risk), with extended coverage covering the Improvements issued in an amount and by a company acceptable to Lender, containing a loss payable or other endorsement satisfactory to Lender insuring Lender as mortgagee, together with such other endorsements as may be required by Lender, including stipulations that coverages will not be cancelled or diminished without at least thirty (30) days prior written notice to Lender; (b) owners and General Contractor general liability insurance, public liability and workmen's compensation insurance; (c) flood insurance if required by Lender or applicable law; and (d) all other insurance required by this Agreement or by the Related Documents.

**Workers' Compensation Coverage.** Provide to Lender proof of the General Contractor's compliance with all applicable workers' compensation laws and regulations with regard to all work performed on the Project.

**Payment of Fees and Expenses.** Borrower shall have paid to Lender all fees, charges, and other expenses which are then due and payable as specified in this Agreement or any Related Document.

**Satisfactory Construction.** All work usually done at the stage of construction for which disbursement is requested shall have been done in a good and workmanlike manner and all materials and fixtures usually furnished and installed at that stage of construction shall have been furnished and installed, all in compliance with the Plans and Specifications. Borrower shall also have furnished to Lender such proofs as Lender may require to establish the progress of the work, compliance with applicable laws, freedom of the Property from liens, and the basis for the requested disbursement.

**Certification.** Borrower shall have furnished to Lender a certification by an engineer, architect, or other qualified inspector acceptable to Lender that the construction of the Improvements has complied and will continue to comply with all applicable statutes, ordinances, codes, regulations, and similar requirements.

**Lien Waivers.** Borrower shall have obtained and attached to each application for an Advance, including the Advance to cover final payment to the General Contractor, executed acknowledgments of payments of all sums due and releases of mechanic's and materialmen's liens, satisfactory to Lender, from any party having lien rights, which acknowledgments of payment and releases of liens shall cover all work, labor, equipment, materials done, supplied, performed, or furnished prior to such application for an Advance.

**No Event of Default.** There shall not exist at the time of any Advance a condition which would constitute an Event of Default under this Agreement or under any Related Document.

**DISBURSEMENT OF LOAN FUNDS.** The following provisions relate to the disbursement of funds from the Loan Fund.

**Application for Advances.** Each application shall be stated on a standard AIA payment request form or other form approved by Lender, executed by Borrower, and supported by such evidence as Lender shall reasonably require. Borrower shall apply only for disbursement with respect to work actually done by the General Contractor and for materials and equipment actually incorporated into the Project. Each application for an Advance shall be deemed a certification of Borrower that as of the date of such application, all representations and warranties contained in the Agreement are true and correct, and that Borrower is in compliance with all of the provisions of this Agreement.

**Payments.** At the sole option of Lender, Advances may be paid in the joint names of Borrower and the General Contractor, subcontractor(s), or supplier(s) in payment of sums due under the Construction Contract. At its sole option, Lender may directly pay the

SJA00164

CP 793

A4

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 4

General Contractor and any subcontractors or other parties the sums due under the Construction Contract. Borrower appoints Lender as its attorney-in-fact to make such payments. This power shall be deemed coupled with an interest, shall be irrevocable, and shall survive an event of Default under this Agreement.

**Projected Cost Overruns.** If Lender at any time determines in its sole discretion that the amount in the Loan Fund is insufficient, or will be insufficient, to complete fully and to pay for the Project, then within ten (10) days after receipt of a written request from Lender, Borrower shall deposit in the Loan Fund an amount equal to the deficiency as determined by Lender. The judgment and determination of Lender under this section shall be final and conclusive. Any such amounts deposited by Borrower shall be disbursed prior to any Loan proceeds.

**Final Payment to General Contractor.** Upon completion of the Project and fulfillment of the Construction Contract to the satisfaction of Lender and provided sufficient Loan Funds are available, Lender shall make an Advance to cover the final payment due to the General Contractor upon delivery to Lender of endorsements to the ALTA title insurance policy following the posting of the completion notice, as provided under applicable law. Construction shall not be deemed complete for purposes of final disbursement unless and until Lender shall have received all of the following:

- (1) Evidence satisfactory to Lender that all work under the Construction Contract requiring inspection by any governmental authority with jurisdiction has been duly inspected and approved by such authority, that a certificate of occupancy has been issued, and that all parties performing work have been paid, or will be paid, for such work;
- (2) A certification by an engineer, architect, or other qualified inspector acceptable to Lender that the Improvements have been completed substantially in accordance with the Plans and Specifications and the Construction Contract, that direct connection has been made to all utilities set forth in the Plans and Specifications, and that the Project is ready for occupancy; and
- (3) Acceptance of the completed Improvements by Lender and Borrower.

**Construction Default.** If Borrower fails in any respect to comply with the provisions of this Agreement or if construction ceases before completion regardless of the reason, Lender, at its option, may refuse to make further Advances, may accelerate the indebtedness under the terms of the Note, and without thereby impairing any of its rights, powers, or privileges, may enter into possession of the construction site and perform or cause to be performed any and all work and labor necessary to complete the improvements, substantially in accordance with the Plans and Specifications.

**Damage or Destruction.** If any of the Collateral or Improvements is damaged or destroyed by casualty of any nature, within sixty (60) days thereafter Borrower shall restore the Collateral and Improvements to the condition in which they were before such damage or destruction with funds other than those in the Loan Fund. Lender shall not be obligated to make disbursements under this Agreement until such restoration has been accomplished.

**Adequate Security.** When any event occurs that Lender determines may endanger completion of the Project or the fulfillment of any condition or covenant in this Agreement, Lender may require Borrower to furnish, within ten (10) days after delivery of a written request, adequate security to eliminate, reduce, or indemnify Lender against, such danger. In addition, upon such occurrence, Lender in its sole discretion may advance funds or agree to undertake to advance funds to any party to eliminate, reduce, or indemnify Lender against, such danger or to complete the Project. All sums paid by Lender pursuant to such agreements or undertakings shall be for Borrower's account and shall be without prejudice to Borrower's rights, if any, to receive such funds from the party to whom paid. All sums expended by Lender in the exercise of its option to complete the Project or protect Lender's interests shall be payable to Lender on demand together with interest from the date of the Advance at the rate applicable to the Loan. In addition, any Advance of funds under this Agreement, including without limitation direct disbursements to the General Contractor or other parties in payment of sums due under the Construction Contract, shall be deemed to have been expended by or on behalf of Borrower and to have been secured by Lender's Deed of Trust, if any, on the Collateral.

**CESSATION OF ADVANCES.** If Lender has made any commitment to make any Loan to Borrower, whether under this Agreement or under any other agreement, Lender shall have no obligation to make Loan Advances or to disburse Loan proceeds if: (A) Borrower or any Guarantor is in default under the terms of this Agreement or any of the Related Documents or any other agreement that Borrower or any Guarantor has with Lender; (B) Borrower or any Guarantor dies, becomes incompetent or becomes insolvent, files a petition in bankruptcy or similar proceedings, or is adjudged a bankrupt; (C) there occurs a material adverse change in Borrower's financial condition, in the financial condition of any Guarantor, or in the value of any Collateral securing any Loan; or (D) any Guarantor seeks, claims or otherwise attempts to limit, modify or revoke such Guarantor's guaranty of the Loan or any other loan with Lender.

**LIMITATION OF RESPONSIBILITY.** The making of any Advance by Lender shall not constitute or be interpreted as either (A) an approval or acceptance by Lender of the work done through the date of the Advance, or (B) a representation or indemnity by Lender to any party against any deficiency or defect in the work or against any breach of any contract. Inspections and approvals of the Plans and Specifications, the Improvements, the workmanship and materials used in the Improvements, and the exercise of any other right of inspection, approval, or inquiry granted to Lender in this Agreement are acknowledged to be solely for the protection of Lender's interests, and under no circumstances shall they be construed to impose any responsibility or liability of any nature whatsoever on Lender to any party. Neither Borrower nor any contractor, subcontractor, materialman, laborer, or any other person shall rely, or have any right to rely, upon Lender's determination of the appropriateness of any Advance. No disbursement or approval by Lender shall constitute a representation by Lender as to the nature of the Project, its construction, or its intended use for Borrower or for any other person, nor shall it constitute an indemnity by Lender to Borrower or to any other person against any deficiency or defects in the Project or against any breach of any contract.

**AFFIRMATIVE COVENANTS.** Borrower covenants and agrees with Lender that, so long as this Agreement remains in effect, Borrower will:

**Notices of Claims and Litigation.** Promptly inform Lender in writing of (1) all material adverse changes in Borrower's financial condition, and (2) all existing and all threatened litigation, claims, investigations, administrative proceedings or similar actions affecting Borrower or any Guarantor which could materially affect the financial condition of Borrower or the financial condition of any Guarantor.

**Financial Records.** Maintain its books and records in accordance with GAAP, applied on a consistent basis, and permit Lender to examine and audit Borrower's books and records at all reasonable times.

**Financial Statements.** Furnish Lender with the following:

**Interim Statements.** As soon as available, but in no event later than ninety (90) days after the end of each Half-year, Borrower's balance sheet and profit and loss statement for the period ended, prepared by Borrower.

**Tax Returns.** As soon as available, but in no event later than one-hundred-twenty (120) days after the applicable filing date for the tax reporting period ended, Federal and other governmental tax returns, prepared by a tax professional satisfactory to Lender.

All financial reports required to be provided under this Agreement shall be prepared in accordance with GAAP, applied on a consistent basis, and certified by Borrower as being true and correct.

SJA00165

CP 794

A5

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 5

**Additional Information.** Furnish such additional information and statements, lists of assets and liabilities, agings of receivables and payables, inventory schedules, budgets, forecasts, tax returns, and other reports with respect to Borrower's financial condition and business operations as Lender may request from time to time.

**Other Agreements.** Comply with all terms and conditions of all other agreements, whether now or hereafter existing, between Borrower and any other party and notify Lender immediately in writing of any default in connection with any other such agreements.

**Insurance.** Maintain fire and other risk insurance, hail, federal crop insurance, public liability insurance, and such other insurance as Lender may require with respect to Borrower's properties and operations, in form, amounts, coverages and with insurance companies acceptable to Lender. Borrower, upon request of Lender, will deliver to Lender from time to time the policies or certificates of insurance in form satisfactory to Lender, including stipulations that coverages will not be cancelled or diminished without at least thirty (30) days prior written notice to Lender. Each insurance policy also shall include an endorsement providing that coverage in favor of Lender will not be impaired in any way by any act, omission or default of Borrower or any other person. In connection with all policies covering assets in which Lender holds or is offered a security interest for the Loans, Borrower will provide Lender with such lender's loss payable or other endorsements as Lender may require.

**Insurance Reports.** Furnish to Lender, upon request of Lender, reports on each existing insurance policy showing such information as Lender may reasonably request, including without limitation the following: (1) the name of the insurer; (2) the risks insured; (3) the amount of the policy; (4) the properties insured; (5) the then current property values on the basis of which insurance has been obtained, and the manner of determining those values; and (6) the expiration date of the policy. In addition, upon request of Lender (however not more often than annually), Borrower will have an independent appraiser satisfactory to Lender determine, as applicable, the actual cash value or replacement cost of any Collateral. The cost of such appraisal shall be paid by Borrower.

**Loan Fees, Charges and Expenses.** Whether or not the Project is completed, Borrower also shall pay upon demand all out-of-pocket expenses incurred by Lender in connection with the preparation of loan documents and the making of the Loan, including, without limitation, all closing costs, fees, and disbursements, all expenses of Lender's legal counsel, and all title examination fees, title insurance premiums, appraisal fees, survey costs, required fees, and filing and recording fees.

**Loan Proceeds.** Use the Loan Funds solely for payment of bills and expenses directly related to the Project.

**Taxes, Charges and Liens.** Pay and discharge when due all of its indebtedness and obligations, including without limitation all assessments, taxes, governmental charges, levies and liens, of every kind and nature, imposed upon Borrower or its properties, income, or profits, prior to the date on which penalties would attach, and all lawful claims that, if unpaid, might become a lien or charge upon any of Borrower's properties, income, or profits.

**Performance.** Perform and comply, in a timely manner, with all terms, conditions, and provisions set forth in this Agreement, in the Related Documents, and in all other instruments and agreements between Borrower and Lender. Borrower shall notify Lender immediately in writing of any default in connection with any agreement.

**Inspection.** Permit employees or agents of Lender at any reasonable time to inspect any and all Collateral for the Loan or Loans and Borrower's other properties and to examine or audit Borrower's books, accounts, and records and to make copies and memoranda of Borrower's books, accounts, and records. If Borrower now or at any time hereafter maintains any records (including without limitation computer generated records and computer software programs for the generation of such records) in the possession of a third party, Borrower, upon request of Lender, shall notify such party to permit Lender free access to such records at all reasonable times and to provide Lender with copies of any records it may request, all at Borrower's expense.

**Compliance Certificates.** Unless waived in writing by Lender, provide Lender at least annually, with a certificate executed by Borrower's chief financial officer, or other officer or person acceptable to Lender, certifying that the representations and warranties set forth in this Agreement are true and correct as of the date of the certificate and further certifying that, as of the date of the certificate, no Event of Default exists under this Agreement.

**Construction of the Project.** Commence construction of the Project no later than March 1, 2008, and cause the Improvements to be constructed and equipped in a diligent and orderly manner and in strict accordance with the Plans and Specifications approved by Lender, the Construction Contract, and all applicable laws, ordinances, codes, regulations, and rights of adjoining or concurrent property owners.

**Defects.** Upon demand of Lender, promptly correct any defect in the Improvements or any departure from the Plans and Specifications not approved by Lender in writing before further work shall be done upon the portion of the Improvements affected.

**Project Claims and Litigation.** Promptly inform Lender of (1) all material adverse changes in the financial condition of the General Contractor; (2) any litigation and claims, actual or threatened, affecting the Project or the General Contractor, which could materially affect the successful completion of the Project or the ability of the General Contractor to complete the Project as agreed; and (3) any condition or event which constitutes a breach or default under any of the Related Documents or any contract related to the Project.

**Payment of Claims and Removal of Liens.** (1) Cause all claims for labor done and materials and services furnished in connection with the Improvements to be fully paid and discharged in a timely manner, (2) diligently file or procure the filing of a valid notice of completion of the Improvements, or such comparable document as may be permitted under applicable lien laws, (3) diligently file or procure the filing of a notice of cessation, or such comparable document as may be permitted under applicable lien laws, upon the happening of cessation of labor on the Improvements for a continuous period of thirty (30) days or more, and (4) take all reasonable steps necessary to remove all claims of liens against the Collateral, the Improvements or any part of the Collateral or Improvements, or any rights or interests appurtenant to the Collateral or Improvements. Upon Lender's request, Borrower shall make such demands or claims upon or against laborers, materialmen, subcontractors, or other persons who have furnished or claim to have furnished labor, services, or materials in connection with the Improvements, which demands or claims shall under the laws of the State of Washington require diligent assertions of lien claims upon penalty of loss or waiver thereof. Borrower shall, within ten (10) days after the filing of any claim of lien that is disputed or contested by Borrower, provide Lender with a surety bond issued by a surety acceptable to Lender sufficient to release the claim of lien or deposit with Lender an amount satisfactory to Lender for the possibility that the contest will be unsuccessful. If Borrower fails to remove any lien on the Collateral or Improvements or provide a bond or deposit pursuant to this provision, Lender may pay such lien, or may contest the validity of the lien, and Borrower shall pay all costs and expenses of such contest, including Lender's reasonable attorneys' fees.

**Taxes and Claims.** Pay and discharge when due all of Borrower's indebtedness, obligations, and claims that, if unpaid, might become a lien or charge upon the Collateral or Improvements; provided, however, that Borrower shall not be required to pay and discharge any such indebtedness, obligation, or claim so long as (1) its legality shall be contested in good faith by appropriate proceedings, (2) the indebtedness, obligation, or claim does not become a lien or charge upon the Collateral or Improvements, and (3) Borrower shall have established on its books adequate reserves with respect to the amount contested in accordance with GAAP. If the indebtedness, obligation, or claim does become a lien or charge upon the Collateral or Improvements, Borrower shall remove the lien or charge as provided in the preceding paragraph.

SJA00166

CP 795

A6

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 6

**Environmental Studies.** Promptly conduct and complete, at Borrower's expense, all such investigations, studies, samplings and testings as may be requested by Lender or any governmental authority relative to any substance, or any waste or by-product of any substance defined as toxic or a hazardous substance under applicable federal, state, or local law, rule, regulation, order or directive, at or affecting any property or any facility owned, leased or used by Borrower.

**Additional Assurances.** Make, execute and deliver to Lender such promissory notes, mortgages, deeds of trust, security agreements, assignments, financing statements, instruments, documents and other agreements as Lender or its attorneys may reasonably request to evidence and secure the Loans and to perfect all Security Interests in the Collateral and Improvements.

**LENDER'S EXPENDITURES.** If any action or proceeding is commenced that would materially affect Lender's interest in the Collateral or if Borrower fails to comply with any provision of this Agreement or any Related Documents, including but not limited to Borrower's failure to discharge or pay when due any amounts Borrower is required to discharge or pay under this Agreement or any Related Documents, Lender on Borrower's behalf may (but shall not be obligated to) take any action that Lender deems appropriate, including but not limited to discharging or paying all taxes, liens, security interests, encumbrances and other claims, at any time levied or placed on any Collateral and paying all costs for insuring, maintaining and preserving any Collateral. All such expenditures incurred or paid by Lender for such purposes will then bear interest at the rate charged under the Note from the date incurred or paid by Lender to the date of repayment by Borrower. All such expenses will become a part of the indebtedness and, at Lender's option, will (A) be payable on demand; (B) be added to the balance of the Note and be apportioned among and be payable with any installment payments to become due during either (1) the term of any applicable insurance policy; or (2) the remaining term of the Note; or (C) be treated as a balloon payment which will be due and payable at the Note's maturity.

**NEGATIVE COVENANTS.** Borrower covenants and agrees with Lender that while this Agreement is in effect, Borrower shall not, without the prior written consent of Lender:

**Indebtedness and Liens.** (1) Except for trade debt incurred in the normal course of business and indebtedness to Lender contemplated by this Agreement, create, incur or assume indebtedness for borrowed money, including capital leases, (2) sell, transfer, mortgage, assign, pledge, lease, grant a security interest in, or encumber any of Borrower's assets (except as allowed as Permitted Liens), or (3) sell with recourse any of Borrower's accounts, except to Lender.

**Continuity of Operations.** (1) Engage in any business activities substantially different than those in which Borrower is presently engaged, (2) cease operations, liquidate, merge, transfer, acquire or consolidate with any other entity, change its name, dissolve or transfer or sell Collateral out of the ordinary course of business, or (3) make any distribution with respect to any capital account, whether by reduction of capital or otherwise.

**Loans, Acquisitions and Guaranties.** (1) Loan, invest in or advance money or assets to any other person, enterprise or entity, (2) purchase, create or acquire any interest in any other enterprise or entity, or (3) incur any obligation as surety or guarantor other than in the ordinary course of business.

**Modification of Contract.** Make or permit to be made any modification of the Construction Contract.

**Liens.** Create or allow to be created any lien or charge upon the Collateral or the Improvements.

**Agreements.** Borrower will not enter into any agreement containing any provisions which would be violated or breached by the performance of Borrower's obligations under this Agreement or in connection herewith.

**GENERAL PROJECT PROVISIONS.** The following provisions relate to the construction and completion of the Project:

**Change Orders.** All requests for changes in the Plans and Specifications, other than minor changes involving no extra cost, must be in writing, signed by Borrower and the architect, and delivered to Lender for its approval. Borrower will not permit the performance of any work pursuant to any change order or modification of the Construction Contract or any subcontract without the written approval of Lender. Borrower will obtain any required permits or authorizations from governmental authorities having jurisdiction before approving or requesting a new change order.

**Purchase of Materials; Conditional Sales Contracts.** No materials, equipment, fixtures, or articles of personal property placed in or incorporated into the Project shall be purchased or installed under any Security Agreement or other agreement whereby the seller reserves or purports to reserve title or the right of removal or repossession, or the right to consider such items as personal property after their incorporation into the Project, unless otherwise authorized by Lender in writing.

**Lender's Right of Entry and Inspection.** Lender and its agents shall have at all times the right of entry and free access to the Property and the right to inspect all work done, labor performed, and materials furnished with respect to the Project. Lender shall have unrestricted access to and the right to copy all records, accounting books, contracts, subcontracts, bills, statements, vouchers, and supporting documents of Borrower relating in any way to the Project.

**Lender's Right to Stop Work.** If Lender in good faith determines that any work or materials do not conform to the approved Plans and Specifications or sound building practices, or otherwise depart from any of the requirements of this Agreement, Lender may require the work to be stopped and withhold disbursements until the matter is corrected. In such event, Borrower will promptly correct the work to Lender's satisfaction. No such action by Lender will affect Borrower's obligation to complete the Improvements on or before the Completion Date. Lender is under no duty to supervise or inspect the construction or examine any books and records. Any inspection or examination by Lender is for the sole purpose of protecting Lender's security and preserving Lender's rights under this Agreement. No default of Borrower will be waived by any inspection by Lender. In no event will any inspection by Lender be a representation that there has been, or will be compliance with the Plans and Specifications or that the construction is free from defective materials or workmanship.

**Indemnity.** Borrower shall indemnify, defend, and hold Lender harmless from any and all claims asserted against Lender or the Property by any person, entity, or governmental body, or arising out of or in connection with the Property, Improvements, or Project. Lender shall be entitled to appear in any proceedings to defend itself against such claims, and all costs and expenses attorneys' fees incurred by Lender in connection with such defense shall be paid by Borrower to Lender. Lender shall, in its sole discretion, be entitled to settle or compromise any asserted claims against it, and such settlement shall be binding upon Borrower for purposes of this indemnification. All amounts paid by Lender under this paragraph shall be secured by Lender's security agreement or Deed of Trust, if any, on the Property, shall be deemed an additional principal Advance under the Loan, payable upon demand, and shall bear interest at the rate applicable to the Loan.

**Publicity.** Lender may display a sign at the construction site informing the public that Lender is the construction lender for the Project. Lender may obtain other publicity in connection with the Project through press releases and participation in ground-breaking and opening ceremonies and similar events.

**Actions.** Lender shall have the right to commence, appear in, or defend any action or proceeding purporting to affect the rights, duties, or liabilities of the parties to this Agreement, or the disbursement of funds from the Loan Fund. In connection with this right, Lender may incur and pay reasonable costs, expenses and attorneys' fees. Borrower covenants to pay to Lender on demand all such expenses, together with interest from the date Lender incurs the expense at the rate specified in the Note, and Lender is authorized to disburse funds

SJA00167

CP 796

A7

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 7

from the Loan Fund for such purposes.

**RIGHT OF SETOFF.** To the extent permitted by applicable law, Lender reserves a right of setoff in all Borrower's accounts with Lender (whether checking, savings, or some other account). This includes all accounts Borrower holds jointly with someone else and all accounts Borrower may open in the future. However, this does not include any IRA or Keogh accounts, or any trust accounts for which setoff would be prohibited by law. Borrower authorizes Lender, to the extent permitted by applicable law, to charge or setoff all sums owing on the indebtedness against any and all such accounts, and, at Lender's option, to administratively freeze all such accounts to allow Lender to protect Lender's charge and setoff rights provided in this paragraph.

**DEFAULT.** Each of the following shall constitute an Event of Default under this Agreement:

**Payment Default.** Borrower fails to make any payment when due under the Loan.

**Other Defaults.** Borrower fails to comply with or to perform any other term, obligation, covenant or condition contained in this Agreement or in any of the Related Documents or to comply with or to perform any term, obligation, covenant or condition contained in any other agreement between Lender and Borrower.

**Environmental Default.** Failure of any party to comply with or perform when due any term, obligation, covenant or condition contained in any environmental agreement executed in connection with any Loan.

**Default in Favor of Third Parties.** Borrower or any Grantor defaults under any loan, extension of credit, security agreement, purchase or sales agreement, or any other agreement, in favor of any other creditor or person that may materially affect any of Borrower's or any Grantor's property or Borrower's or any Grantor's ability to repay the Loans or perform their respective obligations under this Agreement or any of the Related Documents.

**False Statements.** Any warranty, representation or statement made or furnished to Lender by Borrower or on Borrower's behalf under this Agreement or the Related Documents is false or misleading in any material respect, either now or at the time made or furnished or becomes false or misleading at any time thereafter.

**Death or Insolvency.** The dissolution of Borrower (regardless of whether election to continue is made), any member withdraws from Borrower, or any other termination of Borrower's existence as a going business or the death of any member, the insolvency of Borrower, the appointment of a receiver for any part of Borrower's property, any assignment for the benefit of creditors, any type of creditor workout, or the commencement of any proceeding under any bankruptcy or insolvency laws by or against Borrower.

**Defective Collateralization.** This Agreement or any of the Related Documents ceases to be in full force and effect (including failure of any collateral document to create a valid and perfected security interest or lien) at any time and for any reason.

**Creditor or Forfeiture Proceedings.** Commencement of foreclosure or forfeiture proceedings, whether by judicial proceeding, self-help, repossession or any other method, by any creditor of Borrower or by any governmental agency against any collateral securing the Loan. This includes a garnishment of any of Borrower's accounts, including deposit accounts, with Lender. However, this Event of Default shall not apply if there is a good faith dispute by Borrower as to the validity or reasonableness of the claim which is the basis of the creditor or forfeiture proceeding and if Borrower gives Lender written notice of the creditor or forfeiture proceeding and deposits with Lender monies or a surety bond for the creditor or forfeiture proceeding, in an amount determined by Lender, in its sole discretion, as being an adequate reserve or bond for the dispute.

**Breach of Construction Contract.** The Improvements are not constructed in accordance with the Plans and Specifications or in accordance with the terms of the Construction Contract.

**Cessation of Construction.** Prior to the completion of construction of the Improvements and equipping of the Project, the construction of the Improvements or the equipping of the Project is abandoned or work thereon ceases for a period of more than ten (10) days for any reason, or the Improvements are not completed for purposes of final payment to the General Contractor prior to the completion date represented by Borrower to Lender, regardless of the reason for the delay.

**Transfer of Property.** Sale, transfer, hypothecation, assignment, or conveyance of the Property or the Improvements or any portion thereof or interest therein by Borrower or any Borrower without Lender's prior written consent.

**Condemnation.** All or any material portion of the Collateral is condemned, seized, or appropriated without compensation, and Borrower does not within thirty (30) days after such condemnation, seizure, or appropriation, initiate and diligently prosecute appropriate action to contest in good faith the validity of such condemnation, seizure, or appropriation.

**Events Affecting Guarantor.** Any of the preceding events occurs with respect to any Guarantor of any of the indebtedness or any Guarantor dies or becomes incompetent, or revokes or disputes the validity of, or liability under, any Guaranty of the indebtedness. In the event of a death, Lender, at its option, may, but shall not be required to, permit the Guarantor's estate to assume unconditionally the obligations arising under the guaranty in a manner satisfactory to Lender, and, in doing so, cure any Event of Default.

**Adverse Change.** A material adverse change occurs in Borrower's financial condition, or Lender believes the prospect of payment or performance of the Loan is impaired.

**Right to Cure.** If any default, other than a default on indebtedness, is curable and if Borrower or Grantor, as the case may be, has not been given a notice of a similar default within the preceding twelve (12) months, it may be cured if Borrower or Grantor, as the case may be, after receiving written notice from Lender demanding cure of such default: (1) cure the default within fifteen (15) days; or (2) if the cure requires more than fifteen (15) days, immediately initiate steps which Lender deems in Lender's sole discretion to be sufficient to cure the default and thereafter continue and complete all reasonable and necessary steps sufficient to produce compliance as soon as reasonably practical.

**EFFECT OF AN EVENT OF DEFAULT; REMEDIES.** Upon the occurrence of any Event of Default and at any time thereafter, Lender may, at its option, but without any obligation to do so, and in addition to any other right Lender without notice to Borrower may have, do any one or more of the following without notice to Borrower: (a) Cancel this Agreement; (b) Institute appropriate proceedings to enforce the performance of this Agreement; (c) Withhold further disbursement of Loan Funds; (d) Expend funds necessary to remedy the default; (e) Take possession of the Property and continue construction of the Project; (f) Accelerate maturity of the Note and/or indebtedness and demand payment of all sums due under the Note and/or indebtedness; (g) Bring an action on the Note and/or indebtedness; (h) Foreclose Lender's security agreement or Deed of Trust, if any, on the Property in any manner available under law; and (i) Exercise any other right or remedy which it has under the Note or Related Documents, or which is otherwise available at law or in equity or by statute.

**COMPLETION OF IMPROVEMENTS BY LENDER.** If Lender takes possession of the Collateral, it may take any and all actions necessary in its judgment to complete construction of the Improvements, including but not limited to making changes in the Plans and Specifications, work, or materials and entering into, modifying or terminating any contractual arrangements, subject to Lender's right at any time to discontinue any work without liability. If Lender elects to complete the Improvements, it will not assume any liability to Borrower or to any other person for

SJA00168

CP 797

A8

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 8

completing the Improvements or for the manner or quality of construction of the Improvements, and Borrower expressly waives any such liability. Borrower irrevocably appoints Lender as its attorney-in-fact, with full power of substitution, to complete the improvements, at Lender's option, either in Borrower's name or in its own name. In any event, all sums expended by Lender in completing the construction of the Improvements will be considered to have been disbursed to Borrower and will be secured by the Collateral for the Loan. Any such sums that cause the principal amount of the Loan to exceed the face amount of the Note will be considered to be an additional loan to Borrower, bearing interest at the Note rate and being secured by the Collateral. For these purposes, Borrower assigns to Lender all of its right, title and interest in and to the Project Documents; however Lender will not have any obligation under the Project Documents unless Lender expressly hereafter agrees to assume such obligations in writing. Lender will have the right to exercise any rights of Borrower under the Project Documents upon the occurrence of an Event of Default. Except as may be prohibited by applicable law, all of Lender's rights and remedies, whether evidenced by this Agreement or by any other writing, shall be cumulative and may be exercised singularly or concurrently.

**ADDITIONAL DOCUMENTS.** Borrower shall provide Lender with the following additional documents:

**Articles of Organization and Company Resolutions.** Borrower has provided or will provide Lender with a certified copy of Borrower's Articles of Organization, together with a certified copy of resolutions properly adopted by the members of the company, under which the members authorized one or more designated members or employees to execute this Agreement, the Note and any and all Security Agreements directly or indirectly securing repayment of the same, and to consummate the borrowings and other transactions as contemplated under this Agreement, and to consent to the remedies following any default by Borrower as provided in this Agreement and in any Security Agreements.

**Opinion of Counsel.** When required by Lender, Borrower has provided or will provide Lender with an opinion of Borrower's counsel certifying to and that: (1) Borrower's Note, any Security Agreements and this Agreement constitute valid and binding obligations on Borrower's part that are enforceable in accordance with their respective terms; (2) Borrower is validly existing and in good standing; (3) Borrower has authority to enter into this Agreement and to consummate the transactions contemplated under this Agreement; and (4) such other matters as may have been requested by Lender or by Lender's counsel.

**STATUTE OF FRAUDS ACKNOWLEDGEMENT. ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.**

**STATUTE OF FRAUDS ACKNOWLEDGEMENT. UNDER ARIZONA LAW, A CONTRACT, PROMISE, UNDERTAKING OR COMMITMENT TO LOAN MONEY OR TO GRANT OR EXTEND CREDIT, OR CONTRACT, PROMISE, UNDERTAKING OR COMMITMENT TO EXTEND, RENEW OR MODIFY A LOAN OR OTHER EXTENSION OF CREDIT INVOLVING BOTH AN AMOUNT GREATER THAN TWO HUNDRED FIFTY THOUSAND DOLLARS (\$250,000.00) AND NOT MADE OR EXTENDED PRIMARILY FOR PERSONAL, FAMILY OR HOUSEHOLD PURPOSES, MUST BE IN WRITING AND SIGNED BY THE PARTY TO BE CHARGED TO BE ENFORCEABLE.**

**CONSTRUCTION LOAN AGREEMENT ADDENDUMS.**

**DOCUMENT CLARIFICATION:** The name Architect (s) also means the name Engineer(s) throughout this Construction Loan Agreement.

**REPRESENTATION AND WARRANTIES Section:**

**Organization Clause:** We are inserting the words "when applicable" into The sentence "Specifically, Borrower is, and at all times shall be, when applicable, duly qualified as a foreign".

**Lien Priority Clause:** Refer to the Subordination Agreement existing or being created for specific changes to this clause. **A&D LOAN PRODUCT ONLY.**

**Title to Property Clause:** A Private Street may apply to this property and is an acceptable property access as long as a property executed ingress/Egress is recorded with the Deed of Trust.

**Utility Services Clause:** In some cases Utilities may not be available at the boundaries of the Collateral and must be brought to the construction site. **A&D LOAN PRODUCT ONLY.**

**CONDITIONS PRECEDENT TO EACH ADVANCE Section:**

The words "If requested by Lender" are inserted into this sentence at "under this Agreement, if requested by Lender, shall be"

**Architects and Construction Contracts Clause:** The name Architect's also means the name Engineers. **A&D LOAN PRODUCT ONLY.**  
This statement is not applicable on a **SPEC LOAN PRODUCT ONLY.**

**Budget and Schedule of Estimated Advances Clause:** This statement is not applicable on a **SPEC LOAN PRODUCT ONLY.**

**Bond Clause:** This statement is not applicable.

**Insurance Clause:** Flood insurance is not applicable on an **A&D LOAN PRODUCT ONLY.**

**Certification Clause:** This statement is not applicable.

**Lien Waivers Clause:** At the beginning of this clause the words "If requested by Lender" are to be inserted.

**DISBURSEMENT OF LOAN FUNDS Section:**

**Final Payment to General Contractor Clause:** A Certificate of Occupancy is not required on an **A&D LOAN PRODUCT ONLY.**

**AFFIRMATION COVENANTS Section:**

**Insurance Clause:** We do not require federal crop insurance.

**Compliance Certificates Clause:** This statement will only apply upon the Request of the Lender for Compliance Certificates. At that time the certificates are due to the Lender within 60 days.

**GENERAL PROJECT PROVISIONS Section:**

**Change Orders Clause:** The word "submitted" is inserted into the sentence "All requests for changes in the Plans and Specifications, other than minor changes involving no extra cost, must be submitted in writing, signed by Borrower".

**DEFINITIONS Section:**

**Improvements Clause:** Evidence satisfactory to Lender evidencing that the proposed improvements comply with all applicable zoning

SJA00169

CP 798

A9

**CONSTRUCTION LOAN AGREEMENT  
(Continued)**

Loan No: 1579000125

Page 9

ordinances, building and use restrictions and codes and any requirements with respect to licenses, permits, and agreements necessary for the lawful use and operation of the premises, and that the final plat for the proposed development loans been filed and approved by all governmental bodies or agencies having authority over said development.

**Plans and Specifications Clause:** The words "If required" are to be inserted into the sentence "The words "Plans and Specifications" mean the plans and specifications for the project which have been submitted and initialed, if required by Lender".

→ **ASSIGNMENT OF PLANS, ETC..** An exhibit, titled "Assignment of Plans, Contracts and Entitlements," is attached to this Agreement and by this reference is made a part of this Agreement just as if all the provisions, terms and conditions of the Exhibit had been fully set forth in this Agreement.

**PARTIAL RELEASE.** An exhibit, titled "Partial Release," is attached to this Agreement and by this reference is made a part of this Agreement just as if all the provisions, terms and conditions of the Exhibit had been fully set forth in this Agreement.

**MISCELLANEOUS PROVISIONS.** The following miscellaneous provisions are a part of this Agreement:

**Amendments.** This Agreement, together with any Related Documents, constitutes the entire understanding and agreement of the parties as to the matters set forth in this Agreement. No alteration of or amendment to this Agreement shall be effective unless given in writing and signed by the party or parties sought to be charged or bound by the alteration or amendment.

**Attorneys' Fees; Expenses.** Borrower agrees to pay upon demand all of Lender's costs and expenses, including Lender's attorneys' fees and Lender's legal expenses, incurred in connection with the enforcement of this Agreement. Lender may hire or pay someone else to help enforce this Agreement, and Borrower shall pay the costs and expenses of such enforcement. Costs and expenses include Lender's attorneys' fees and legal expenses whether or not there is a lawsuit, including attorneys' fees and legal expenses for bankruptcy proceedings (including efforts to modify or vacate any automatic stay or injunction), appeals, and any anticipated post-judgment collection services. Borrower also shall pay all court costs and such additional fees as may be directed by the court.

→ **Authority to File Notices.** Borrower appoints and designates Lender as its attorney-in-fact to file for the record any notice that Lender deems necessary to protect its interest under this Agreement. This power shall be deemed coupled with an interest and shall be irrevocable while any sum or performance remains due and owing under any of the Related Documents.

**Caption Headings.** Caption headings in this Agreement are for convenience purposes only and are not to be used to interpret or define the provisions of this Agreement.

**Governing Law.** This Agreement will be governed by federal law applicable to Lender and, to the extent not preempted by federal law, the laws of the State of Washington without regard to its conflicts of law provisions. This Agreement has been accepted by Lender in the State of Washington.

**Choice of Venue.** If there is a lawsuit, Borrower agrees upon Lender's request to submit to the jurisdiction of the courts of King County, State of Washington.

**Indemnification of Lender.** Borrower agrees to indemnify, to defend and to save and hold Lender harmless from any and all claims, suits, obligations, damages, losses, costs and expenses (including, without limitation, Lender's attorneys' fees, as well as Lender's architect's and engineering fees), demands, liabilities, penalties, fines and forfeitures of any nature whatsoever that may be asserted against or incurred by Lender, its officers, directors, employees, and agents arising out of, relating to, or in any manner occasioned by this Agreement and the exercise of the rights and remedies granted Lender under this. The foregoing indemnity provisions shall survive the cancellation of this Agreement as to all matters arising or accruing prior to such cancellation and the foregoing indemnity shall survive in the event that Lender elects to exercise any of the remedies as provided under this Agreement following default hereunder.

**Consent to Loan Participation.** Borrower agrees and consents to Lender's sale or transfer, whether now or later, of one or more participation interests in the Loan to one or more purchasers, whether related or unrelated to Lender. Lender may provide, without any limitation whatsoever, to any one or more purchasers, or potential purchasers, any information or knowledge Lender may have about Borrower or about any other matter relating to the Loan, and Borrower hereby waives any rights to privacy Borrower may have with respect to such matters. Borrower additionally waives any and all notices of sale of participation interests, as well as all notices of any repurchase of such participation interests. Borrower also agrees that the purchasers of any such participation interests will be considered as the absolute owners of such interests in the Loan and will have all the rights granted under the participation agreement or agreements governing the sale of such participation interests. Borrower further waives all rights of offset or counterclaim that it may have now or later against Lender or against any purchaser of such a participation interest and unconditionally agrees that either Lender or such purchaser may enforce Borrower's obligation under the Loan irrespective of the failure or insolvency of any holder of any interest in the Loan. Borrower further agrees that the purchaser of any such participation interests may enforce its interests irrespective of any personal claims or defenses that Borrower may have against Lender.

**No Waiver by Lender.** Lender shall not be deemed to have waived any rights under this Agreement unless such waiver is given in writing and signed by Lender. No delay or omission on the part of Lender in exercising any right shall operate as a waiver of such right or any other right. A waiver by Lender of a provision of this Agreement shall not prejudice or constitute a waiver of Lender's right otherwise to demand strict compliance with that provision or any other provision of this Agreement. No prior waiver by Lender, nor any course of dealing between Lender and Borrower, or between Lender and any Grantor, shall constitute a waiver of any of Lender's rights or of any of Borrower's or any Grantor's obligations as to any future transactions. Whenever the consent of Lender is required under this Agreement, the granting of such consent by Lender in any instance shall not constitute continuing consent to subsequent instances where such consent is required and in all cases such consent may be granted or withheld in the sole discretion of Lender.

**Severability.** If a court of competent jurisdiction finds any provision of this Agreement to be illegal, invalid, or unenforceable as to any circumstance, that finding shall not make the offending provision illegal, invalid, or unenforceable as to any other circumstance. If feasible, the offending provision shall be considered modified so that it becomes legal, valid and enforceable. If the offending provision cannot be so modified, it shall be considered deleted from this Agreement. Unless otherwise required by law, the illegality, invalidity, or unenforceability of any provision of this Agreement shall not affect the legality, validity or enforceability of any other provision of this Agreement.

**Successors and Assigns.** All covenants and agreements by or on behalf of Borrower contained in this Agreement or any Related Documents shall bind Borrower's successors and assigns and shall inure to the benefit of Lender and its successors and assigns. Borrower shall not, however, have the right to assign Borrower's rights under this Agreement or any interest therein, without the prior written consent of Lender.

**Survival of Representations and Warranties.** Borrower understands and agrees that in extending Loan Advances, Lender is relying on all representations, warranties, and covenants made by Borrower in this Agreement or in any certificate or other instrument delivered by Borrower to Lender under this Agreement or the Related Documents. Borrower further agrees that regardless of any investigation made by Lender, all such representations, warranties and covenants will survive the extension of Loan Advances and delivery to Lender of the

SJA00170

CP 799

A10

## CONSTRUCTION LOAN AGREEMENT (Continued)

Related Documents, shall be continuing in nature, shall be deemed made and redated by Borrower at the time each Loan Advance is made, and shall remain in full force and effect until such time as Borrower's Indebtedness shall be paid in full, or until this Agreement shall be terminated in the manner provided above, whichever is the last to occur.

**Time is of the Essence.** Time is of the essence in the performance of this Agreement.

**DEFINITIONS.** The following capitalized words and terms shall have the following meanings when used in this Agreement. Unless specifically stated to the contrary, all references to dollar amounts shall mean amounts in lawful money of the United States of America. Words and terms used in the singular shall include the plural, and the plural shall include the singular, as the context may require. Words and terms not otherwise defined in this Agreement shall have the meanings attributed to such terms in the Uniform Commercial Code. Accounting words and terms not otherwise defined in this Agreement shall have the meanings assigned to them in accordance with generally accepted accounting principles as in effect on the date of this Agreement:

**Advance.** The word "Advance" means a disbursement of Loan funds made, or to be made, to Borrower or on Borrower's behalf on a line of credit or multiple advance basis under the terms and conditions of this Agreement.

**Agreement.** The word "Agreement" means this Construction Loan Agreement, as this Construction Loan Agreement may be amended or modified from time to time, together with all exhibits and schedules attached to this Construction Loan Agreement from time to time.

**Architect's Contract.** The words "Architect's Contract" mean the architect's contract between Borrower and the architect for the Project.

**Borrower.** The word "Borrower" means David Alan Development, LLC and includes all co-signers and co-makers signing the Note and all their successors and assigns.

**Collateral.** The word "Collateral" means all property and assets granted as collateral security for a Loan, whether real or personal property, whether granted directly or indirectly, whether granted now or in the future, and whether granted in the form of a security interest, mortgage, collateral mortgage, deed of trust, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor's lien, equipment trust, conditional sale, trust receipt, lien, charge, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever, whether created by law, contract, or otherwise.

**Completion Date.** The words "Completion Date" mean such date as Lender shall have established as the date by which Borrower is to have completed the Project as required in this Agreement.

**Construction Contract.** The words "Construction Contract" mean the contract between Borrower and the general contractor for the Project, and any subcontracts with subcontractors, materialmen, laborers, or any other person or entity for performance of work on the Project or the delivery of materials to the Project.

**Event of Default.** The words "Event of Default" mean any of the events of default set forth in this Agreement in the default section of this Agreement.

**GAAP.** The word "GAAP" means generally accepted accounting principles.

**Grantor.** The word "Grantor" means each and all of the persons or entities granting a Security Interest in any Collateral for the Loan, including without limitation all Borrowers granting such a Security Interest.

**Guarantor.** The word "Guarantor" means any guarantor, surety, or accommodation party of any or all of the Loan and any guarantor under a completion guaranty agreement.

**Guaranty.** The word "Guaranty" means the guaranty from Guarantor to Lender, including without limitation a guaranty of all or part of the Note.

**Improvements.** The word "Improvements" means all existing and future buildings, structures, facilities, fixtures, additions, and similar construction on the Collateral.

**Indebtedness.** The word "Indebtedness" means the indebtedness evidenced by the Note or Related Documents, including all principal and interest together with all other indebtedness and costs and expenses for which Borrower is responsible under this Agreement or under any of the Related Documents.

**Lender.** The word "Lender" means Sterling Savings Bank, its successors and assigns.

**Loan.** The word "Loan" means the loan or loans made to Borrower under this Agreement and the Related Documents as described.

**Loan Fund.** The words "Loan Fund" mean the undisbursed proceeds of the Loan under this Agreement together with any equity funds or other deposits required from Borrower under this Agreement.

**Note.** The word "Note" means the promissory note dated November 5, 2007, in the original principal amount of \$3,050,000.00 from Borrower to Lender, together with all renewals of, extensions of, modifications of, refinancings of, consolidations of, and substitutions for the promissory note or agreement.

**Permitted Liens.** The words "Permitted Liens" mean (1) liens and security interests securing indebtedness owed by Borrower to Lender; (2) liens for taxes, assessments, or similar charges either not yet due or being contested in good faith; (3) liens of materialmen, mechanics, warehousemen, or carriers, or other like liens arising in the ordinary course of business and securing obligations which are not yet delinquent; (4) purchase money liens or purchase money security interests upon or in any property acquired or held by Borrower in the ordinary course of business to secure indebtedness outstanding on the date of this Agreement or permitted to be incurred under the paragraph of this Agreement titled "Indebtedness and Liens"; (5) liens and security interests which, as of the date of this Agreement, have been disclosed to and approved by the Lender in writing; and (6) those liens and security interests which in the aggregate constitute an immaterial and insignificant monetary amount with respect to the net value of Borrower's assets.

**Plans and Specifications.** The words "Plans and Specifications" mean the plans and specifications for the Project which have been submitted to and initialed by Lender, together with such changes and additions as may be approved by Lender in writing.

**Project.** The word "Project" means the construction project as described in the "Project Description" section of this Agreement.

**Project Documents.** The words "Project Documents" mean the Plans and Specifications, all studies, data and drawings relating to the Project, whether prepared by or for Borrower, the Construction Contract, the Architect's Contract, and all other contracts and agreements relating to the Project or the construction of the Improvements.

**Property.** The word "Property" means the property as described in the "Project Description" section of this Agreement.

**Real Property.** The words "Real Property" mean the real property, interests and rights, as further described in the "Project Description" section of this Agreement.

SJA00171

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CONSTRUCTION LOAN AGREEMENT  
(Continued)

Loan No: 1579000125

Page 11

**Related Documents.** The words "Related Documents" mean all promissory notes, credit agreements, loan agreements, environmental agreements, guaranties, security agreements, mortgages, deeds of trust, security deeds, collateral mortgages, and all other instruments, agreements and documents, whether now or hereafter existing, executed in connection with the Loan.

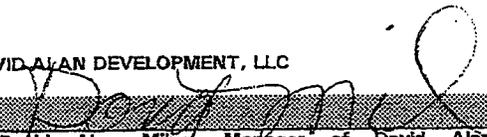
**Security Agreement.** The words "Security Agreement" mean and include without limitation any agreements, promises, covenants, arrangements, understandings or other agreements, whether created by law, contract, or otherwise, evidencing, governing, representing, or creating a Security Interest.

**Security Interest.** The words "Security Interest" mean, without limitation, any and all types of collateral security, present and future, whether in the form of a lien, charge, encumbrance, mortgage, deed of trust, security deed, assignment, pledge, crop pledge, chattel mortgage, collateral chattel mortgage, chattel trust, factor's lien, equipment trust, conditional sale, trust receipt, lien or title retention contract, lease or consignment intended as a security device, or any other security or lien interest whatsoever whether created by law, contract, or otherwise.

BORROWER ACKNOWLEDGES HAVING READ ALL THE PROVISIONS OF THIS CONSTRUCTION LOAN AGREEMENT AND BORROWER AGREES TO ITS TERMS. THIS CONSTRUCTION LOAN AGREEMENT IS DATED NOVEMBER 5, 2007.

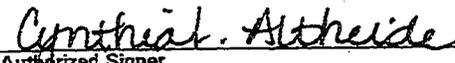
BORROWER:

DAVID ALAN DEVELOPMENT, LLC

By:   
David Alan Milne, Manager of David Alan Development, LLC

LENDER:

STERLING SAVINGS BANK

By:   
Cynthia Altheide  
Authorized Signer

SJA00172

A12

CP 801

**APPENDIX B**

**ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS  
(WITH COUNSEL'S NOTATIONS)**

# ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS

Principal	Loan Date	Maturity	Loan No.	Cat/Col	Account	Office	Initials
\$3,050,000.00	11-05-2007	12-31-2008	1572000122	R/C		LAV	
References in the boxes above are for Lender's use only and do not limit the applicability of this document to any particular loan or item. Any item above containing "****" has been omitted due to text length limitations.							

**Borrower:** David Alan Development, LLC  
 914 164th St SE #12  
 Mill Creek, WA 98012

**Lender:** Sterling Savings Bank  
 Bellevue Construction Lending  
 Action Mortgage Company  
 11400 SE 8th Street Suite 110  
 Bellevue, WA 98004-6431

This ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS is attached to and by this reference is made a part of the Construction Loan Agreement, dated November 5, 2007, and executed in connection with a loan or other financial accommodations between STERLING SAVINGS BANK and David Alan Development, LLC.

## ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS

This ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS ("Assignment") is made as of NOVEMBER 5, 2007, by DAVID ALAN DEVELOPMENTLLC, an AZ Limited Liability Company ("Borrower"), for the benefit of STERLING SAVINGS BANK, a Washington state chartered bank, its successors and assigns ("Lender").

### RECITALS

A. Pursuant to the terms of that certain Construction Loan Agreement dated on or about the date hereof by and between Borrower and Lender (the "Loan Agreement"), Lender has agreed to loan to Borrower the maximum principal sum of THREE MILLION FIFTY THOUSAND and 00/100 Dollars (\$3,050,000.00) (the "Loan") for the purposes specified in the Loan Agreement, which purposes include the construction of certain improvements ("Improvements") described in plans and specifications required under the Loan Agreement ("Plans and Specifications") upon certain real property (the "Real Property") described in the Loan Agreement (the Real Property and the Improvements are collectively referred to here in as the "Property"). Capitalized terms used but not defined here in shall have the meaning ascribed to such terms in the Loan Agreement.

B. As a condition to making the Loan, Lender requires Borrower to execute this Assignment and deliver it to Lender.

### AGREEMENT

NOW, THEREFORE, for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. Assignment of Plans, Contracts and Entitlements. As additional security for the Loan, Borrower hereby assigns, transfers and pledges to Lender all of its rights, powers, privileges, claims and causes of action, and all of its right, title and interest in and to and proceeds from: (i) all designs, drawings, plans, specifications, trademarks, logos and other work product prepared or to be prepared in connection with the development, construction, management, marketing and sale of all or any part of the Property, now or hereafter existing, together with all existing and future amendments, modifications and supplements thereof, including, without limitation, the Plans and Specifications (collectively, the "Plans"), (ii) all contracts of every kind relating to the acquisition, development, construction, management, marketing and sale of all or any part of the Property, including, without limitation, construction contracts and subcontracts, contracts with architects, engineers and other service providers, supply contracts, joint development agreements, marketing agreements, financing agreements and purchase and sale agreements, now or hereafter existing, together with all existing and future amendments, modifications and supplements thereto (collectively, the "Contracts"), and (iii) all permits, licenses, approvals, applications, variances and entitlements concerning all or any part of the Property, now or hereafter existing, together with all existing and future amendments, modifications and supplements thereof (collectively, the "Entitlements," and, together with the Plans and Contracts, the "Assigned Collateral"). Lender may, at its election, describe on Exhibit A attached hereto and incorporated herein by reference those elements of the Assigned Collateral initially subject to this Assignment, and Lender may, at its election, update or supplement such description from time to time. Notwithstanding anything to the contrary contained herein, the failure or refusal by Lender to (i) initially describe the Assigned Collateral on Exhibit A hereto, or (ii) update or supplement such description shall not affect the validity or enforceability of this Assignment. Borrower agrees that any such updating and supplementing is optional and not required, and any list or description on Exhibit A is not intended to be exhaustive.

2. License. Provided no default exists under any of the Loan Documents, Borrower shall have a license to utilize the Assigned Collateral in accordance with the terms thereof. if a default under any of the Loan Documents shall have occurred and be continuing, Borrower's license specified in the immediately preceding sentence shall cease and terminate without the execution of any further instrument or document or the taking of any other act on the part of Lender, and in such event, Lender shall be entitled to utilize the Assigned Collateral in Borrower's place and stead, in the name of Borrower or otherwise, and in furtherance thereof, Lender may enter upon the Property and take possession thereof by its officers, agents or employees, or by a court-appointed receiver, and for the operation, protection, repair and maintenance of the Property, and in connection therewith, Lender shall be entitled to take possession of and use all books of account and financial records of Borrower and its property managers or representatives relating to the Property.

3. Lender Authorized to Demand Performance. Upon the occurrence of a default under any of the Loan Documents, Borrower hereby authorizes Lender, and for this purpose irrevocably constitutes and appoints Lender as its attorney-in-fact, coupled with an interest, to use the Assigned Collateral for further development and construction on the Property, to demand, receive and enforce Borrower's rights under the Assigned Collateral, to make payments and give appropriate receipts, releases and satisfactions under such Assigned Collateral, and to perform any and all acts with respect to the Assigned Collateral that Lender deems necessary or desirable, all on behalf of and in the name of Borrower, or at Lender's option in Lender's own name, with the same force and effect as if performed by Borrower. Lender may also reassign its rights hereunder to another person designated by Lender, which person shall have the same rights to utilize and enforce the rights of Lender under the Assigned Collateral. Lender shall have and possess, without limitation, any and all rights and remedies of a secured party under the UCC in effect in the state in which the Property is located or as otherwise provided by the laws of such state.

4. Lender Not Liable. Neither this Assignment nor any action or inaction on the part of Lender shall constitute an assumption on the part of Lender of any duty or obligation with respect to the Assigned Collateral, nor shall Lender have any duty or obligation to make any payment to be made by Borrower under the Assigned Collateral, or to present or file any claim, or to take any other action to collect or enforce the payment of any amounts or the performance of any obligations which have been assigned to Lender or to which it may be entitled hereunder at any time or times. No action or inaction on the part of Lender shall adversely affect or limit in any way the rights of Lender hereunder or under

SJA00196

B2

CP 802

**ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS  
(Continued)**

Loan No: 1579000125

Page 2

the Assigned Collateral, and Lender shall not incur any liability on account of any action taken or not taken by it or on its behalf in connection with the Assigned Collateral, regardless of whether the same shall prove to be improper, inadequate or invalid, in whole or in part.

5. **Security.** This Assignment is for security purposes only and is made to secure payment of all amounts, and the performance of each and every obligation of Borrower, under the Loan Documents and under any other instrument executed by Borrower with respect to the Property.

6. **Borrower's Representations and Warranties.** Borrower represents and warrants to Lender:

6.1 There have been no prior assignments of Borrower's interest in the Assigned Collateral;

6.2 Borrower has full power, authority and right to assign its right, title and interest in and to the Assigned Collateral to Lender and, with respect to the assignment of each element of the Assigned Collateral, either: (i) Borrower has obtained and delivered to Lender a consent to such assignment in a form and content satisfactory to Lender, or (ii) no consents or approvals of any persons or entities under such Assigned Collateral are necessary for Borrower to validly execute and deliver this Assignment and perform its obligations hereunder; and

6.3 Each element of the Assigned Collateral constitutes the valid and binding agreement, obligation or right of the parties thereto, as applicable, enforceable by and against such parties in accordance with its terms, and neither Borrower nor, to the best of Borrower's knowledge following diligent investigation, any other party to such Assigned Collateral is in default under the terms of such Assigned Collateral, except for any defaults previously disclosed by Borrower to Lender in writing.

7. **No Modification or Further Assignment.** Without Lender's prior written consent, which consent may be withheld in Lender's sole and absolute discretion, Borrower shall not: (i) make any material amendments or modifications to the Assigned Collateral, or (ii) assign, pledge, mortgage or otherwise transfer or encumber any of its right, title or interest in or to any of the Assigned Collateral while any of Borrower's obligations under the Loan Documents remain outstanding.

8. **Indemnity.** Borrower will indemnify and hold Lender harmless from and against any and all claims, demands, liabilities, losses, lawsuits, judgments, damages, costs and expenses, including, without limitation, attorneys' fees and costs (whether or not in litigation, on appeal or in bankruptcy court, including adversarial proceedings and appeals of any bankruptcy order), to which Lender may become exposed or which lender may incur in exercising any of its rights under this Assignment or the Assigned Collateral.

9. **Successors and Assigns.** Subject to the provisions of Section 7 hereof, this Assignment is binding upon and shall inure to the benefit of the legal representatives, successors and assigns of Borrower, Lender and any lenders now or hereafter participating in the Loan. Lender may freely assign its rights hereunder to any other person or entity without the consent of Borrower.

10. **Reliance by Other Parties.** This Assignment shall be conclusive evidence of Lender's rights hereunder and may be relied upon by any architect, engineer, construction contractor or subcontractor, supplier of materials or labor, or other party to any of the Assigned Collateral.

11. **Severability.** If any term or provision of this Assignment is finally adjudicated to be illegal, invalid or unenforceable, in whole or in part, it will be deemed deleted to that extent, and all other terms and provisions of this Assignment will remain in full force and effect.

12. **Notices.** All notices hereunder shall be given and effective in accordance with the terms of the Loan Agreement.

13. **Governing Law.** This Assignment shall be governed by the law of the state in which the Property is located without regard to that state's choice of law rules.

14. **Further Assurances.** Borrower, at its sole cost and expense, shall execute and deliver all such instruments and take all such action as Lender, from time to time, may reasonably request in order to obtain the full benefits of this Assignment and of the rights and powers herein created and to maintain and perfect the security interest granted in this Assignment.

15. **STATUTE OF FRAUDS ACKNOWLEDGEMENT**

ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.

UNDER ARIZONA LAW, A CONTRACT, PROMISE, UNDERTAKING OR COMMITMENT TO LOAN MONEY OR TO GRANT OR EXTEND CREDIT, OR A CONTRACT PROMISE, UNDERTAKING OR COMMITMENT TO EXTEND, RENEW OR MODIFY A LOAN OR OTHER EXTENSION OF CREDIT INVOLVING BOTH AN AMOUNT GREATER THAN TWO HUNDRED FIFTY THOUSAND (\$250,000) DOLLARS AND NOT MADE OR EXTENDED PRIMARILY FOR PERSONAL, FAMILY OR HOUSEHOLD PURPOSES, ARE INVALID.

[Execution signatures appear on following pages.]

IN WITNESS WHEREOF, Borrower has duly executed this Assignment as of the date first written above.

BORROWER:

DAVID ALAN DEVELOPMENT, LLC, an AZ Limited Liability Company,

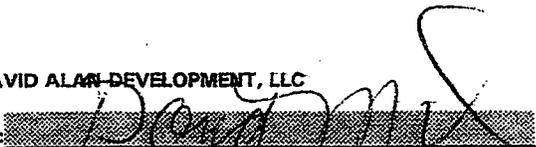
**Exhibit A  
SCHEDULE OF ASSIGNED COLLATERAL**

This Schedule is optional, and this Assignment is effective even if this Exhibit A is blank.

THIS ASSIGNMENT OF PLANS, CONTRACTS AND ENTITLEMENTS IS EXECUTED ON NOVEMBER 5, 2007.

BORROWER:

DAVID ALAN DEVELOPMENT, LLC

By:   
David Alan Milne, Manager of David Alan Development, LLC

SJA00197

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CP 803

1 CERTIFICATE OF SERVICE

2 I hereby certify that on February 22, 2010, I caused to be served a copy of the  
3 foregoing Appellant's Brief on the following in the manner indicated below:  
4

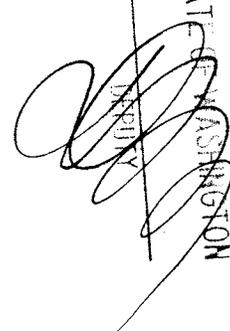
5 Matthew Z. Crotty  
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31 VIA EMAIL

32 APPELLANT'S BRIEF  
33 CERTIFICATE OF SERVICE - 1

BY  DENNY  
STATE OF WASHINGTON

10 FEB 23 AM 11:15

FILED  
COURT OF APPEALS  
BOTHELL

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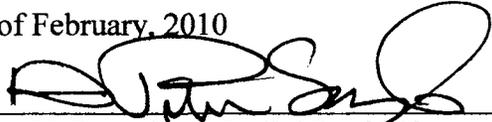
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APPELLANT'S BRIEF  
CERTIFICATE OF SERVICE - 2

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1 Dated this 22<sup>nd</sup> day of February, 2010

2 Certified by



3 H. Peter Sorg, Jr. WSBA 9149

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