ORIGINAL

81833-9

No. 36340-2-II

FILED
COURT OF APPEALS
DIVISION II
07 NOV -1 PM 1:12
STATE OF WASHINGTON
BY
DEPUTY

COURT OF APPEALS, DIVISION II

OF THE STATE OF WASHINGTON

N. JACK ALHADEFF,

Appellant,

v.

KITSAP COMMUNITY FEDERAL CREDIT UNION,
dba KITSAP CREDIT UNION,

Respondent.

BRIEF OF RESPONDENT

Brian C. Read WSBA 34091
Frank R. Siderius WSBA 7759
SIDERIUS LONERGAN & MARTIN, LLP
500 Union Street, Suite 847
Seattle, WA 98101
206/624-2800

TABLE OF CONTENTS

A. RESPONSE TO ASSIGNMENT OF ERROR 1

B. STATEMENT OF THE CASE 1

1. Introduction 1
2. Statement of Facts 2

C. STATEMENT OF ISSUES 6

D. ARGUMENT 6

1. Standard of Review 6

2. Appellant's Causes of Action Arise Under Article 5 of the UCC, Regardless of How They are Framed 6

3. Breach of Contract Causes of Action Fail Because There Simply is No Contract 7

4. Respondent Owed Appellant No Duty Outside of Article 5 Upon Which Appellant's Other Causes of Action Could Be Based. 10

5. Appellant Is Really Asserting A Breach of Warranty Claim Under Article 5 10

6. *Krause v. Stroh Brewery Co.* is Controlling Authority and the One-year Statute of Limitations Bars Appellant's Claims Against Respondent 13

E. CONCLUSION 18

TABLE OF AUTHORITIES

Cases

Krause v. Stroh Brewery, 240 F.Supp.2d 632
(E.D. Mich. 2002) 1, 6, 16-18

Statutes

RCW 62A.5-103 . . . . . 6, 7

RCW 62A.5-103(1) 6

RCW 62A.5-110 . . . . . 10-14, 16

RCW 62A.5-110(1)(b) 7, 10, 11, 13, 19

RCW 62A.5-115 . . . . . 1, 7, 13, 14, 17

RCW Ch. 62A.5-101 1

Other Authorities

L. Lawrence, Anderson on the Uniform Commercial Code,
Vol. 7A §5.115:5 15

MCLS § 440.5110 16

MCLS § 440.5115 17

A. RESPONSE TO ASSIGNMENT OF ERROR

The trial court properly granted summary judgment in favor of respondent Kitsap Community Federal Credit Union. All of appellant's causes of action against respondent are based on wrongful collection upon a letter of credit and are barred by the one-year statute of limitations in RCW 62A.5-115.

B. STATEMENT OF THE CASE

1. Introduction

The trial court granted respondent Kitsap Community Federal Credit Union's motion for summary judgment, dismissing all claims of appellant. (Summary Judgment, CP 145-148.)

The trial court agreed with respondent's analysis that respondent had no obligation or liability to appellant in contract, tort, or otherwise, other than those arising under the letter of credit transaction. The trial court further found that the parties' relationship arose solely out of Article 5 of the Uniform Commercial Code, RCW Ch. 62A.5-101, *et seq.* No Washington cases address the issue. The trial court adopted the reasoning of *Krause v. Stroh Brewery*, 240 F.Supp.2d 632 (E.D. Mich. 2002) in applying the one-year statute of limitations to bar appellant's claims. (RP 29-32.)

Appellant attempts to avoid the obvious application of Article 5 to this lawsuit by couching his causes of action as common law contract, tort, and equitable claims outside the scope of Article 5. However, appellant fails to point to the existence of any contract, tort, or equitable obligation that would give appellant any right or benefit that is in any way meaningfully different from the rights or benefits that he was otherwise entitled to as the letter of credit applicant in an Article 5 transaction. Appellant concedes that he could have brought an action against respondent for breach of respondent's Article 5 warranty to appellant, but did not. (Brief of Appellant, p. 32.)

Appellant's position ignores the undisputed facts of this case and also ignores the only judicial decision which is directly on point.

2. Statement of Facts

Appellant N. Jack Alhadeff has been self employed for approximately 30 years as a real estate investor or real estate broker. (CP 33.)

On June 27, 2003, respondent Kitsap Credit Union entered into a construction loan transaction with the Meridian on Bainbridge Island, LLC (hereafter "Meridian"). One condition of Kitsap Credit Union's loan commitment was that Meridian contribute additional equity into the project by means of an irrevocable letter of credit in the amount of $1 million.

Appellant caused his bank, Wells Fargo Bank, to provide Kitsap Credit Union the letter of credit for the benefit of Meridian. Wells Fargo issued the letter of credit on July 2, 2003. By its terms, the letter of credit expired June 24, 2004. (CP 41-42.) Kitsap Credit Union took draws against the letter of credit on May 11, 2004, June 11, 2004 and July 8, 2004. (See Amended Complaint, ¶¶ 9 - 17, CP 5-8.)

Appellant is unable to identify any contract or agreement between appellant and respondent Kitsap Credit Union separate and apart from the letter of credit document itself. Appellant did enter into a Letter of Credit Agreement with Meridian. It is undisputed that respondent is *not* a party to that contract. There is no evidence that respondent ever saw that contract prior to this lawsuit. "Upon the terms and conditions set forth in that certain Letter of Credit Agreement...with Meridian" appellant "caused his bank" to provide the $1 million letter of credit to respondent. (See Amended Complaint, ¶12, CP 6.) Appellant's claims and causes of action against Meridian and the other defendants in this lawsuit arise out of the Letter of Credit Agreement. (See Amended Complaint, ¶¶ 45-55, CP 12-15.) The terms and conditions of appellant's contract with Meridian have not been presented to the court.

Appellant alleges that correspondence between him and respondent credit union form a "Letter Agreement;" that respondent agreed to honor an assignment agreement between appellant and Meridian as provided in the Letter of Credit Agreement to which respondent was not a party; that respondent had a duty to advise appellant that Meridian changed the scope of its project. (Brief of Appellant, pp. 3-5, 7-9.)

The "letter agreement" correspondence between the parties culminated in respondent credit union's letter to appellant dated July 1, 2003. (CP 74.) By its terms this letter sets forth the credit union's agreement regarding the letter of credit and refers to conditions expressly set forth in the letter of credit itself. (CP 41.) There is no evidence of an assignment agreement. Similarly, there is no evidence of an express or implied duty on the part of respondent to advise appellant of changes in the scope of Meridian's project.

This lawsuit was filed April 18, 2006 and the Amended Complaint with allegations against Kitsap Credit Union was filed August 30, 2006, more than two years after the final draw on the letter of credit. (CP 1.)

Appellant brings causes of action against Kitsap Credit Union for Breach of Contract re: LOC Draw Certifications; Breach of Contract re:

Failure to Disburse Net 10% of Proceeds; Promissory Estoppel re: LOC Draw Certifications; Negligence; Certification of No Defaults; Negligent Misrepresentation; Conversion; and Money Had and Received. (See Amended Complaint, ¶¶ 20-42; CP 8-11.)

When asked to identify all damages appellant claims to have incurred as a result of the causes of action asserted against Kitsap Credit Union, appellant stated: "Without waiving this objection, plaintiff states that his damages are the amounts unpaid under the Letter of Credit Agreement with the Meridian on Bainbridge Island, LLC, which, in addition to costs and attorney's fees, include the following amounts: ..." (See Declaration of Frank R. Siderius, Interrogatory Answer No. 8; CP 35.) How is respondent liable for damages under a contract to which it was not a party?

Appellant did not indicate that his damages included Meridian sale proceeds or any other amounts that allegedly should have been directed to appellant under an assignment agreement or any other assignment theory.

All of appellant's causes of actions and claims for damages arise under the letter of credit transaction set forth in the Amended Complaint. As the trial court stated, "The terms of the letter of credit define all of the obligations the credit union had." (RP 16.)

C. STATEMENT OF ISSUES

1. Do appellant's causes of action arise under Article 5 of the UCC, regardless of how they were pled, because they do not involve any rights in contract, tort, or equity that are meaningfully different from appellant's Article 5 rights?

2. Does the one-year statute of limitations under Article 5 apply to bar appellant's causes of action?

3. Does the case of *Krause v. Stroh Brewery*, *supra*, control in applying a one-year statute of limitations to this action for wrongful collection upon a letter of credit?

D. ARGUMENT

1. Standard of Review

Respondent agrees with appellant that *de novo* is the proper standard of review, for the reasons set forth in appellant's brief.

2. Appellant's Causes of Action Arise Under Article 5 of the UCC, Regardless of How They are Framed

RCW 62A.5-103 defines the scope of Article 5 of the UCC. Specifically, Article 5 "applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit." RCW 62A.5-103(1).

This case involves two such "certain rights and obligations" that Article 5 specifically provides for: RCW 62A.5-110(1)(b)'s warranty by the beneficiary of a letter of credit to the applicant, and RCW 62A.5-115's one-year statute of limitations applying to Article 5 lawsuits.

As Official Comment 2 to RCW 62A.5-103 makes clear, "Normally Article 5 should not be considered to conflict with practice except when a rule . . . is different from a rule *explicitly stated in Article 5*." RCW 62A.5-103, Official Comment 2 (emphasis added). RCW 62A.5-110(1)(b) explicitly provides a cause of action for breach of the warranty by the beneficiary of a letter of credit to the applicant, and RCW 62A.5-115 explicitly provides that the statute of limitations in a lawsuit arising under Article 5 is one year.

3. Breach of Contract Causes of Action Fail Because There Simply is No Contract

Appellant relies on Professors White and Summers' comment that "Article 5 does not . . . deal at all with the underlying contract between the applicant and the beneficiary." (Brief of Appellant, p. 26). Respondent does not dispute this; however, this quotation is irrelevant to the case at bar because there simply is no underlying contract between the parties upon which to base a breach of contract cause of action. Appellant's causes of

action are based upon respondent's wrongful collection upon the letter of credit.

Appellant has claimed that the letter dated July 1, 2003 from respondent credit union to appellant (CP 74) is a "contract" breached by respondent. (Plaintiff's Memorandum in Opposition, CP 57.) However, this letter simply repeats the terms contained in the letter of credit. (CP 41-42.) The letter lacks any reference to any contractual duty or relationship between the parties separate from the letter of credit itself. There is no independent consideration for this alleged contract. The letter contains three numbered paragraphs. Each of these paragraphs reflect terms and conditions already contained in the letter of credit.

Appellant offers no evidence of any contract or other agreement between the parties with terms that are meaningfully different from the terms of the letter of credit. Appellant's first cause of action is "based on respondent's breach of its agreements to make valid certifications to Wells Fargo Bank upon drawing on the LOC." (Brief of Appellant, p. 25.) However, the letter of credit itself spells out the certifications that respondent must make with each draw on the letter of credit.

Appellant's second cause of action for breach of contract alleges that respondent breached its agreement to assign sale proceeds of Meridian condo units to appellant. Referring to the parties' email correspondence, (CP 69-74), appellant apparently believes that a complete and binding assignment agreement sprouted from the phrase:

> [w]e ...suggest that the 10% net proceeds on the sale of units that was designated to Meridian be assigned by Meridian back to Jack. This is much cleaner for us and we would honor that assignment.[1]

Nowhere in the record is there any evidence of an assignment agreement (or any other contract for that matter) executed by appellant and respondent. As the trial judge keenly observed, "I haven't seen this assignment." (RP 28.) There is simply no contract between appellant and respondent, or any connection between them whatsoever, other than the letter of credit, which clearly falls within the purview of Article 5 of the UCC.

---

[1] Whether an assignment of proceeds existed is a moot point because there is simply no evidence that respondent was provided an assignment agreement it should honor. The declaration of appellant states that appellant had an absolute right to payment of 10% of the next proceeds from the sale of any portion of the Meridian project that would otherwise be payable at closing to Meridian. (CP 62.) Yet the contract purportedly setting forth this agreement is the Letter of Credit Agreement which was not before the trial court and to which respondent is not a party and was unaware of its existence prior to this lawsuit.

4. Respondent Owed Appellant No Duty Outside of Article 5 Upon Which Appellant's Other Causes of Action Could Be Based.

Appellant cannot reasonably assert common law tort claims. All of the actions alleged by applicant as negligent involve respondent's alleged wrongful certifications upon drawing on the letter of credit. Appellant can point to no duty -- independent from and meaningfully different than any duty implicit in the letter of credit relationship arising under Article 5 -- that may have been breached. Because no duty arising outside of Article 5 has been breached, there is no basis for a common law tort claim. Likewise, any equitable claim that appellant may have is also inextricably tied to the letter of credit transactions and Article 5 for the same reasons. Appellant cites no equitable claim that is meaningfully different than what appellant could have asserted as a breach of RCW 62A.5-110(1)(b)'s warranty.

5. Appellant Is Really Asserting A Breach of Warranty Claim Under Article 5

Appellant attempts to evade the effect of Article 5 by claiming that Article 5's warranty provisions are inapplicable because appellant has not asserted a breach of warranty claim under Article 5. However, as indicated above, appellant has no basis for any cause of action outside of Article 5. Appellant confuses the meaning of RCW 62A.5-110's Official Comments

and scholarly treatises discussing Article 5 warranties. These sources make it abundantly clear that what appellant is really asserting is a breach of warranty claim under Article 5.

As appellant's brief indicates, appellant was the applicant and respondent was the beneficiary in the letter of credit transaction central to the case at bar. (Brief of Appellant, pp. 18-19.)

RCW 62A.5-110(1)(b) provides:

> (1) If its presentation is honored, the beneficiary warrants:
> ...(b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

The sole legal relationship of appellant and respondent is as parties to a letter of credit transaction. Appellant's only cause of action against respondent can be breach of this Article 5 warranty, regardless of how it is couched. Alleged wrongful certifications when drawing on the letter of credit form the substance of appellant's claims against respondent.

Official Comment 2 to RCW 62A.5-110 indicates that the beneficiary's warranty to the applicant has primary application in "standby letters of credit or *other circumstances where the applicant is not party to an*

underlying contract with the beneficiary."[2] RCW 62A.5-110 Official Comment 2 (emphasis added). As shown above, appellant (applicant) is not a party to an underlying contract with respondent (beneficiary). Whatever contractual relationship appellant had with Meridian or the other defendants in this litigation pursuant to the Letter of Credit Agreement, is irrelevant in that respondent credit union was not a party to that contract.

Official Comment 2 next points out that RCW 62A.5-110 is not a warranty that the statements made on the letter of credit documents presented are truthful or in proper form. Appellant's brief, at p. 30, tweaks the following excerpt to suggest that some separate contractual relationship, apart from the letter of credit itself, is the basis of the applicant's Article 5 warranty:

> It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. RCW 61A.5-110, Official Comment 2.

It reads too much into the plain text of RCW 62A.5-110 to claim that the "underlying agreement" must absolutely mean a contract separate from

---

[2] It is irrelevant whether the letter of credit central to this case was or was not a "standby letter of credit." The letter of credit involved here was an "Irrevocable Letter of credit" by its terms and does not contain the word "standby." (CP 41-42.)

the letter of credit arrangement, especially when considering what appellant's brief omits from Official Comment 2:

> In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), **but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction**. RCW 61A.5-110 Official Comment 2. (Emphasis added.)

Appellant's breach of warranty cause of action arose when respondent credit union drew on the letter of credit allegedly in violation of that document's express obligations. All of appellant's claims, whether disguised in contract, tort, or equity, have a common origin: respondent allegedly took improper draws on the letter of credit. Appellant has identified no other source of appellant's causes of action different from the warranty provisions of RCW 62A.5-110(1)(b). All of appellant's causes of action necessarily fall within the purview of RCW 62A.5-110.

6. *Krause v. Stroh Brewery Co.* is Controlling Authority and the One-year Statute of Limitations Bars Appellant's Claims Against Respondent

RCW 62A.5-115 provides,

> An action to enforce a right or obligation arising under this Article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever occurs later. A cause

> of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

RCW 62A.5-115's one-year statute of limitations is clearly controlling in this case. Official Comment 2 to RCW 62A.5-115 confirms that this statute of limitations applies to claims made under RCW 62A.5-110. Official Comment 3 clarifies that "the statute of limitations, like the rest of the statue, applies. . .only to transactions, events, obligations, or duties *arising out of or associated with* such a letter." RCW 62A.5-115, Official Comment 3 (emphasis added). Appellant states:

> RCW 62A.5-115 does **not**, however, apply to 'claims [that] arose out of an Article 5 transaction,' as KCU argued, or to claims that arose under a 'relationship,' as the trial court concluded; instead, the statute applies to 'an action to enforce a right or obligation arising under' Article 5. (Brief of Appellant, p. 28.)

Appellant's position is clearly without merit and is a futile exercise in semantics. It is apparent from the plain text of RCW 62A.5-115 and its Official Comment 3 that a cause of action brought more than one year after it accrues is time barred, regardless of whether the claim "arises under," "arose out of," or "is associated with" Article 5. Appellant's position that he has not brought "an action to enforce a right or obligation arising under" Article 5, simply because appellant's causes of action are labeled "common

law" is entirely without merit. Appellant's own admission reveals the weakness of his argument: "Certainly, plaintiff's claims *arose out of* the LOC, and plaintiff *would not have had a 'relationship' with KCU but for the LOC*..." (Brief of Appellant, p. 28.)

L. Lawrence, Anderson on the Uniform Commercial Code, Vol. 7A §5.115:5, p. 642, is instructive in this regard:

> This raises the question as to whether a right or obligation arises under Revised Article 5 when it arises from a contract that is entered into under the authority of Revised Article 5.
>
> **Example**: If the applicant sues the issuer for breach of the of the contract between the applicant and the issuer, does such claim arise under Revised Article 5 or does it arise under ordinary contract law?
>
> The Official Comments make it clear that Revised Article 5's statute of limitations applies to all suits on contracts that are authorized, recognized, or contemplated by Revised Article.

Thus, even if appellant could prove the existence of a contract between appellant and respondent, or even if the parties' letter of credit transaction could be deemed a contract, because the subject matter of that contract would involve rights and obligations expressly and specifically covered by Article 5, it follows that the contract would be subject to Article 5's one-year statute of limitations. Appellant's brief acknowledges that appellant's case could have been brought as either an Article 5 or a common

law cause of action. According to appellant, "what is important is that, even though plaintiff could have asserted a warranty claim against KCU, he still has a direct cause of action against KCU for breach of the underlying agreement." (Brief of Appellant, p. 32.)

Moreover, it is illogical to assume that Article 5's one-year statute of limitations could be avoided simply by re-labeling the claim to a common law cause of action. Such a maneuver would violate the paramount objective of the UCC: uniformity, and predictability, in commercial transactions such as letter of credit transactions under Article 5.

Understandably, appellant chooses to ignore the holding in *Krause v. Stroh Brewing Company, supra.* That case involved a dispute over an allegedly wrongful draw on a letter of credit. The plaintiffs alleged several causes of action in contract and tort. *Krause* recognized that "Michigan's enactment of Article 5 of the Uniform Commercial Code governs transactions involving letters of credit." *Krause*, 240 F. Supp. 2d at 635. Therefore, the plaintiffs' claims arose under the warranty provisions of MCLS § 440.5110 (the analogue to UCC 5-110 and RCW 62A.5-110). The court also noted that "*Article 5 includes a one-year statute of limitations period for any 'action to enforce a right or obligation arising under this article ....'*"

Krause, 240 F. Supp. 2d at 635, *citing* MCLS § 440.5115 (the analogue to UCC 5-115 and RCW 62A.5-115) (emphasis in original). "Therefore," the court held, "the one-year statute of limitations applies to actions for wrongfully collecting upon letters of credit." *Krause*, 240 F. Supp. 2d at 635. Because the lawsuit was filed more than one year after the alleged wrongful collection upon the Letter of credit, all of the plaintiffs' causes of action were time barred. *Krause*, 240 F. Supp. 2d at 636. *Krause* is identical to the case before this court. Michigan and Washington have enacted identical versions of Article 5's warranty and one-year statute of limitations provisions. This court should follow *Krause* and the trial court and hold that plaintiff's claims are likewise time barred.

Appellant's pleadings below contained a lengthy discussion of *Krause*, and argue that it does not apply to the case at bar because it involved a standby letter of credit and a contractual relationship between the parties in addition to their letter of credit arrangement. For some reason, appellant's brief on appeal abandons any reference to *Krause* and does not discuss its applicability to the case at bar. Nevertheless, it is worthwhile to mention the error in appellant's analysis below.

Whether the letter of credit was a standby or other type of letter of credit was not at all relevant to the outcome of *Krause.* Nowhere in the opinion is there any reference to standby letters of credit. The opinion does not indicate that the type of letter of credit used is relevant at all. Nor was it relevant to *Krause* that the parties had a contractual relationship separate from their letter of credit agreement.[3] It was only relevant that,

> Michigan's enactment of Article 5 of the Uniform Commercial Code governs *transactions involving letters of credit.* . . . Article 5 also provides a cause of action for *wrongfully collecting on a letter of credit.* . . . Therefore, the one-year statute of limitations applies to actions for wrongfully collecting upon letters of credit. *Krause*, 240 F. Supp. 2d at 635. (Emphasis added.)

Appellant's arguments below simply misread *Krause*, and are not supported by the plain text of Article 5, its Official Comments, or even common sense.

E. CONCLUSION

Appellant sets forth seven causes of action, and correctly explains that principles of law not displaced by the UCC are adopted. Appellant does not explain *why* appellant's causes of action do not arise out of the letter of credit

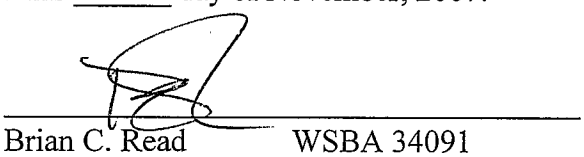
---

[3] In the case at bar, even if, as appellant argues, the parties did have a common law contractual relationship, pursuant to *Krause* and the plain text of UCC § 5-115, Article 5's one-year statute of limitations would still apply because appellant's causes of action all boil down to claims of "wrongful collection" in "transactions involving letters of credit."

transaction and under Article 5 of the UCC. Appellant does not explain *how* his causes of action can arise under the common law, rather than Article 5, when the parties' only relationship to each other is as applicant and beneficiary in a letter of credit transaction.

Appellant seeks to avoid the application of specific Article 5 provisions dealing with warranties and statute of limitations by trying to make this lawsuit what it is not. The only legitimate relationship between the parties alleged in this lawsuit is as applicant and beneficiary to the letter of credit transaction. The factual allegations behind appellant's contract, tort or equity causes of action, all boil down to allegations of wrongful certifications upon each draw on the letter of credit. The legislature has provided appellant with a remedy: a breach of warranty cause of action pursuant to RCW 62A.5-110(1)(b). Appellant sought his remedy too late. Because Article 5 claims are subject to a one year statute of limitations and this action was filed well after that deadline, this court should affirm the Summary Judgment granted below.

Respectfully submitted this 1st day of November, 2007.



Brian C. Read WSBA 34091

Frank R. Siderius WSBA 7759
SIDERIUS LONERGAN & MARTIN LLP
Attorneys for Respondent

FILED
COURT OF APPEALS
DIVISION II
07 NOV -1 PM 4:12
STATE OF WASHINGTON
BY _____
DEPUTY

CERTIFICATE OF SERVICE

The undersigned certifies under penalty of perjury under the laws of the State of Washington that on the date below, I caused delivery by legal messenger a true copy of this document to:

Michael D. Ross
Attorney at Law
2010 - 156th Avenue NE, Ste 100
Bellevue, WA 98007

John J. Mitchell
Attorney at Law
811 - 1st Avenue, Ste 620
Seattle, WA 98104

Dated: November 1, 2007, at Seattle, Washington.

Valerie Loxtercamp