

66420-4

66420-4

No. 664204

THE COURT OF APPEALS
DIVISION I
STATE OF WASHINGTON

BOEING EMPLOYEE'S CREDIT UNION, *Appellant (s)*,

v.

RUSS AND SUZANNE K. BURNS, *Respondent*.

BRIEF OF RESPONDENT(S)
(Amended to add Clerk's Papers citations)

8
JAN 11 2011
COURT OF APPEALS
DIVISION I
STATE OF WASHINGTON

N. Brian Hallaq, WSBA #29621
Jan Gossing, WSBA # 31559
BTA Lawgroup, PLLC
Attorney for Appellant(s)
31811 Pacific Hwy. S., Suite B-101
Federal Way, WA 98003
(253) 444-5660

TABLE OF CONTENTS

TABLE OF AUTHORITIES.....4

A. INTRODUCTION.....5

B. ANSWERS TO ASSIGNMENTS OF ERROR.....6

C. RESTATEMENT OF THE CASE.....6

D. ARGUMENT.....8

Standard of Review.....7

Procedure for reviewing claims under RCW 61.24.080(3).....7

The trial court properly found that BECU’s deed of trust merged into the judgment before the foreclosure...... 10

BECU Waived its Security.....10

A judgment extinguishes the underlying promissory note.....12

RCW 61.24.100 does not apply to non-foreclosing lien holders.....13

The trial court did not err in holding that BECU’s claim is subject to the Burns’ homestead 16

BECU was a judgment creditor at the time of foreclosure:

E. CONCLUSION.....17

TABLE OF AUTHORITIES

Table of Cases

Washington Cases

<u>Beal Bank, SSB v. Sarich</u> , 161 Wn.2d 544, 67 P.3d 555 (2007).....	14
<u>Bradley Engineering etc. Co. v. Muzzy</u> , 54 Wash. 227, 103 P. 37 (1909).....	10
<u>In re the Trustee's Sale of the Real Property of Michael Sweet</u> , 88 Wn. App. 199, 944 P.2d 414 (1997).....	16
<u>In re Upton</u> , 102 Wn. App. 220, 6 P.3d 1231 (2000).....	9
<u>Petri v. Nanny et al.</u> , 99 Wash. 601, 170 p. 127 (1919).....	12
<u>Sullins v. Sullins</u> , 65 Wn.2d 283, 396 P.2d 886 (1964).....	10
<u>Wilson v. Henkle</u> , 45 Wn. App. 162, 724 P.2d 1069 (1986).....	8,9
<u>Woodcraft Construction, Inc., et al., v. Paul S. Hamilton, et al.</u> , 56 Wn. App. 885; 786 P.2d 307 (1990).....	12

Other Cases

(None)

Constitutional Provisions

(None)

Statutes

RCW 6.13.....	6
RCW 6.13.030.....	16
RCW 6.13.080(2).....	5,9
RCW 61.12.....	11
RCW 6.24.....	7
RCW 61.24.080(3).....	4, 5, 6, 8, 9
RCW 61.24.100.....	13, 14, 15
RCW 61.24.100(1).....	14, 15
RCW 61.24.100(2)(a).....	13, 14, 15
RCW 61.24.100(2)(b).....	15

Regulations and Rules

(None)

Other Authorities

(None)

A. INTRODUCTION

This case centers on the application of RCW 61.24.080(3). RCW 61.24.080(3) is the statute that governs the disposition of surplus funds following a non-judicial foreclosure (i.e. the bid at the foreclosure was greater than the amount necessary to satisfy the foreclosing promissory note). Washington's surplus funds statute is an intellectually elegant statute, in that it treats the competing claims to the surplus funds in the same priority as they would have existed against the property. Therefore, the various claimants' claims to the surplus funds are prioritized in terms of the property rights that they possessed in the property prior to the foreclosure. Those property rights could be consensual liens, such as deeds of trust, statutory liens, such as materialman's liens, possessory interests, such as the owner's fee simple, or non-consensual liens, such as a judgment lien.

The surplus funds statute would have the trial court judge imagine that the various claimants were exercising their own rights and remedies as against the property, and prioritize the claims to the surplus funds in terms of which property right would be superior to the other.

For example, if one claimant was a judgment creditor, and the other claimant were a homeowner whose interest in the property qualified as a homestead under RCW 6.13.030, then the homeowner's claim to the surplus funds would defeat that of the judgment creditor's claim up to the

amount of the homestead exemption (\$125,000.00). This is exactly what would have happened if the judgment creditor attempted their own remedy against the property (i.e. foreclosure), since the judgment creditor would have to pay the holder of the homestead the first \$125,000.00 of any funds realized by the sale.

Similarly, a claimant to surplus funds based upon a homestead would lose to the holder of a deed of trust, per RCW 6.13.080(2), as the homestead would not apply to a consensual lienholder such as a deed of trust grantee.

In this case, the question becomes whether a junior deed of trust holder can obtain a civil judgment prior to the non-judicial foreclosure conducted by the senior deed of trust holder and then maintain its priority with respect to the former homeowners' homestead on the basis of its deed of trust.

Put another way, what happens to the lien priority of a deed of trust holder, who elects to sue on the promissory note, and obtain a civil judgment? Does that lienholder retain the priority of a deed of trust holder, or does that lienholder lower its priority to that of a judgment-lien creditor, in exchange for the additional remedies available to judgment lien holders.

The respondents argue that by electing to gain the remedies available to civil judgment creditors, the holder of a deed of trust

relinquishes the lien priority that it held against real property when it only held a deed of trust.

B. ANSWERS ASSIGNMENTS OF ERROR

Assignment of Error No. 1 “The court erred by determining that BECU’s Deed of Trust and Promissory Note merged when BECU obtained a judgment, and that BECU was precluded from claiming the excess funds from the trustee’s sale of the Property.”

Answer to Assignment of Error No. 1: The trial court did not err in applying the merger doctrine. BECU choose to sue and obtain a judgment against Respondents before the foreclosure. As such BECU converted its security from a deed of trust to a judgment and BECU is therefore subject to Respondents’ Homestead Exemption within the meaning of RCW 6.13.

Assignment of Error No. 2 “The court erred by determining that the homestead exemption is available against a judgment lien creditor that is also a deed of trust beneficiary of RCW 61.24.080”

Answer to Assignment of Error No .1: The trial court did not err in holding that the homestead exemption is available against a judgment lien creditor. The court properly applied RCW 61.24.080(3) and RCW 6.13, which mandates that a judgment lien creditor (a non-consensual lien holder) is subject to the former homeowner’s homestead exemption.

C. RESTATEMENT OF THE CASE

Russ and Suzanne Burns were the owners of real property located at 9440 171st Ave. N.E., Redmond, Washington 98052 (*hereinafter* “property”). CP 1-32. The Burns had two loans on the property, a first mortgage in favor of Wells Fargo Bank, N.A. (obtained on December 7, 2004), and a second mortgage in favor of BECU (obtained on October 24, 2005). *Id.*

With respect to the promissory note in favor of BECU for \$85,000.00 obtained on October 24, 2005, that loan was secured by a deed of trust, which was recorded on November 3, 2005 under recording number 20051103000575. *Id.* On October 16, 2008, BECU sent the Burns a notice of default, and on December 5, 2008, BECU recorded a notice of trustee sale with respect to its junior deed of trust, and recorded a notice of discontinuance in February of 2009. *Id.*

On April 14, 2009, BECU elected to file a lawsuit against Russ and Suzanne Burns on the promissory dated October 24, 2005 under King County case number 09-2-15744-8. CP 51-71. On the very same day, BECU obtained a default judgment against the Burns'. *Id.* On October 7, 2009, BECU obtained a writ of garnishment against the Burns'. *Id.*

On August 20, 2010, Northwest Trustee Services, Inc., as Trustee for the senior deed of trust (Wells Fargo Bank, N.A.), performed a trustee's sale pursuant to the provisions for a non-judicial foreclosure contained in RCW 61.24. CP 1-32. At the time of the trustee's sale, BECU held a judgment lien. *Id.* Wells Fargo's trustee sale yielded funds in excess of those necessary to satisfy the obligation owed to them, and the Trustee, pursuant to RCW 61.24.080 deposited the surplus funds into the court registry of the King County Superior Court. *Id.* The funds were deposited on September 22, 2010 in the amount of \$100,648.42. *Id.*

On October 25, 2010, BECU moved for disbursement of the surplus funds deposited by the trustee in August, relying on their 2005

deed of trust. CP 33-34. The Burns' filed their own motion for disbursement of funds on November 16, 2010 pursuant to RCW 61.24.080(3). CP 36-45. At that hearing the Commissioner ruled in favor of the Burns' finding that BECU's lawsuit resulted in a merger of the promissory and deed of trust into its judgment (which was obtained *prior to* Wells Fargo's foreclosure which resulted in surplus funds). CP 82-83. Consequently, BECU was a judgment creditor at the time of foreclosure.

BECU moved for revision which was denied. CP 85-90, 104. The instant appeal ensued.

D. ARGUMENT

Standard of Review:

This court is reviewing the propriety of an order disbursing surplus funds granted under RCW 61.24.080(3). Such matters are reviewed under an abuse of discretion standard. *See, Wilson v. Henkle*, 45 Wn. App. 162, 724 P.2d 1069 (1986). The trial court has broad discretion in determining the priorities of various lien claimants. *Wilson*, 45 App. 162 (1986). Accordingly, the proper standard of review is abuse of discretion.

Procedure for reviewing claims under RCW 61.24.080(3):

RCW 61.24.080(3) provides for the procedure for adjudicating claims related to surplus funds resulting from a non-judicial foreclosure. In ascertaining the relative priorities of competing claimants, RCW 61.24.080(3) provides in relevant part that: “[i]nterests in, or liens or claims of liens against the property eliminated by sale under this section

shall attach to the surplus in the order of priority that it had attached to the property.” RCW 61.24.080(3). Generally, the determination of the relative priorities under RCW 61.24.080(3) is within the discretion of the Superior Court judge. *See, Wilson v. Henkle*, 45 Wn. App. 162, 724 P.2d 1069 (1986).

Therefore, the analysis in the present case is to evaluate the Burns’ interest (i.e. the statutory homestead eliminated by the sale) against the interest of BECU (i.e. the pre-foreclosure judgment which was eliminated by the sale).

Under normal circumstances, when evaluating the relative priorities of a former homeowner versus that of a junior deed of trust grantee under RCW 61.24.080(3), the junior deed of trust would trump the interest of the homeowner. *See, In re Upton*, 102 Wn. App. 220, 6 P.3d 1231 (2000)(homestead protections do not operate against holders of deeds of trust); RCW 6.13.080(2). As a result, BECU’s consensual lien (deed of trust) would normally have priority over the Burns’ claim (homestead).

The critical distinction in this case is that BECU elected to file suit and obtain a civil judgment *before* the foreclosure which resulted in surplus funds. Accordingly, BECU converted its secured interest (deed of trust) into a judgment by suing on the promissory note. Therefore at the

time of the foreclosure, BECU held a judgment lien, not a deed of trust.

See, RCW 61.24.080(3).

THE TRIAL COURT PROPERLY FOUND THAT BECU'S DEED OF TRUST MERGED INTO THE JUDGMENT BEFORE THE FORECLOSURE.

BECU Waived its Security:

BECU does not deny that the bank exercised its right to elect a particular remedy, in this case, a civil judgment. On April 14, 2009, BECU obtained a civil judgment against the Burns', and in fact, even attempted collection activity (a remedy not available to the holder of a deed of trust). BECU argues that its actions should not be viewed as an election of remedies, but rather that the nature and character of the consensual lien retains itself, despite having sued on the underlying promissory note and obtaining a judgment.

It is well-established principle in Washington State that a suit on the promissory note waives the underlying security. Since 1909, no Washington litigant has challenged this principle expounded in Bradley Engineering etc. Co. v. Muzzy, 54 Wash. 227, 103 P. 37 (1909):

The commencement of an action for the recovery of a debt secured by mortgage **not asking a foreclosure of the mortgage and brought before a foreclosure of the mortgage and sale thereunder, shall be, and be deemed to be, a waiver of the mortgage security;** and this provision may not be waived or avoided by agreement contained in the mortgage or otherwise.

Id. at 231 (emphasis added).

Similarly, the Washington State Supreme Court discussed the same principle in Sullins v. Sullins, 65 Wn.2d 283, 396 P.2d 886 (1964).

We have held that a lien is an encumbrance upon the property as security for the payment of a debt. Swanson v. Graham, 27 Wn. (2d) 590, 179 P. (2d) 288; Anderson v. Grays Harbor Cy., 49 Wn. (2d) 89, 297 P. (2d) 1114. The waiver of the lien does not extinguish the debt. **He may elect to abandon the security and sue upon the debt alone.** Frye v. Meyer, 22 Wash. 277, 60 Pac. 655; Federal Land Bank of Spokane v. Miller, 155 Wash. 479, 284 Pac. 751; Seattle Sav. & Loan Ass'n v. Gardner J. Gwinn, Inc., 171 Wash. 695, 19 P. (2d) 111; Blaine v. Gardner J. Gwinn, Inc., 172 Wash. 505, 20 P. (2d) 855.

Id. at 285.

In the instant case, BECU sued the Burns before the non-judicial foreclosure and obtained a judgment. BECU promissory note and deed of trust ceased to exist at that point in time. In other words, a judgment is the final expression of a promise to pay. It reduces promissory notes to court mandated payments and extinguishes securities. As a result of its election of remedies, BECU waived its deed of trust and decided to pursue its legal remedies under the promissory note.

BECU's sole contention to recover from the surplus funds hinges on the continued existence of its security. However, the choice to obtain a judgment barred any further action with respect to the security. BECU can, of course, try to foreclose its judgment pursuant to RCW 61.12 in a judicial foreclosure proceeding. However, further action under Washington's deed of trust act is precluded. It is simply not feasible for BECU to argue that it is possible to hold one promissory note, secured by

a deed of trust, and at the same time, hold a civil judgment obtained by the very same promissory note.

A judgment extinguishes the underlying promissory note:

Similar to waiving a security, a suit on a promissory note extinguishes the promissory note as the debt instrument merges into the judgment. This legal precedent was established early last century when the Washington Supreme Court held that “[w]hen a judgment is obtained on a note or bill, the bill or note is thereby extinguished and merged in the judgment.” *Petri v. Nanny et al.*, 99 Wash. 601, 170 p. 127 (1919). The case was later followed by a myriad of cases, such as *Woodcraft Construction, Inc., et al., v. Paul S. Hamilton, et al.*, 56 Wn. App. 885; 786 P.2d 307 (1990).

However, as noted in *Caine & Weiner v. Barker*, 42 Wn. App. 835, 837, 713 P.2d 1133 (1986): “As a general rule, **when a valid final judgment for the payment of money is rendered, the original claim is extinguished, and a new cause of action on the judgment is substituted for it.**” Here, as in *Caine*, the judgment based upon the promissory note extinguished the note and the debtor then became obligated on the judgment. The attorney fee provision of the note merged into the judgment and ceased to exist. Therefore, there was no contractual basis upon which to award attorney fees and costs to either party.

Woodcraft Construction, Inc., 56 Wn. App. 885 (1990).

When read in conjunction with the line of cases dealing with ‘waivers of security’ discussed above, it becomes clear that BECU’s argument must fail. BECU seeks to emphasize that a mortgage holder may sue and obtain a civil judgment and then foreclose on the property if

the judgment remains unsatisfied. This line of reasoning blurs the distinction between judicial foreclosures, based upon civil actions, and non-judicial foreclosures, which are creatures of statute and are based upon the contractual relationship of the lender and borrower.

BECU correctly asserts that a judgment creditor is permitted to foreclose its lien (judicially); however, BECU fails to specify that judgment creditors are limited to asserting such claims under RCW 61.12 (Washington's judicial foreclosure statute). Additionally, BECU's assertion that RCW 61.24.100 permits a creditor to obtain a judgment and then recover on the basis of its deed of trust is simply incorrect, and not supported by statute or case law.

RCW 61.24.100 does not apply to non-foreclosing lien holders:

BECU relies on a snippet of statutory language contained in RCW 61.24.100 to support its contention that a creditor may have its cake and eat it too. In other words, a creditor may sue on a promissory note and obtain a judgment and later on decide to revive its waived security and seek its remedies (and lien priorities) available under the deed the trust.

Part of BECU's argument focuses on the provisions contained in RCW 61.24.100(2)(a) and (b). RCW 61.24.100 is Washington's anti-deficiency statute, which generally limits a foreclosing lienholder's recovery to the proceeds resulting from trustee sale when electing to foreclose non-judicially on a residential loan. In a recent decision by the

Washington Supreme Court held that RCW 61.24.100 does not apply to non-foreclosing lien holders.

We turn to the plain language of the relevant portion of RCW 61.24.100 and **find the right of nonforeclosing junior lienholders and creditors is simply not implicated.**

Beal Bank, SSB v. Sarich, 161 Wn.2d 544, 67 P.3d 555 (2007) (emphasis added).

According to the Washington Supreme Court, BECU's reliance on the language contained in RCW 61.24.100 is misplaced and BECU's argument with respect to RCW 61.24.100 is simply invalid.

BECU's sole authority for its position is contained in the following section of RCW 61.24.100(1)-(2)(a) & (b):

(1) Except to the extent permitted in this section for deeds of trust securing commercial loans, a deficiency judgment shall not be obtained on the obligations secured by a deed of trust against any borrower, grantor, or guarantor after a trustee's sale under that deed of trust.

(2)

(a) Nothing in this chapter precludes an action against any person liable on the obligations secured by a deed of trust or any guarantor prior to a notice of trustee's sale being given pursuant to this chapter or after the discontinuance of the trustee's sale.

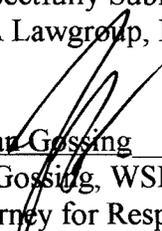
(b) No action under (a) of this subsection precludes the beneficiary from commencing a judicial foreclosure or trustee's sale under the **deed of trust after the completion or dismissal of that action.**

E. CONCLUSION

The issue before the court is, ‘what type of lien did BECU hold at the time of Wells Fargo’s non-judicial foreclosure?’ There is simply no authority to support the theory that BECU can maintain two different types of lien priorities simultaneously. If BECU’s deed of trust was unaltered by the fact that it sued on the underlying promissory note, then BECU’s lien priority would be that of a consensual deed of trust holder, and BECU would prevail in this action. In order to reach that decision, this Court would have to reach a conclusion that has not been adopted by *any* jurisdiction. On the other hand, if this Court adopts the well accepted and settled case law on this subject, it is clear from the analysis that BECU’s civil suit and resulting judgment merged its interests into a vehicle that affords BECU more remedies at law, but which lowers its lien priorities against judgment debtors’ homestead protections.

Dated this 5th day of May, 2011

Respectfully Submitted by:
BTA Lawgroup, PLLC


/s/ Jan Gossing
Jan Gossing, WSBA #31559
Attorney for Respondents