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No. 68978-9-I

DIVISION I, COURT OF APPEALS
OF THE STATE OF WASHINGTON

WASHINGTON FEDERAL SAVINGS AND LOAN ASSOCIATION,
a federal association,

Plaintiff-Appellant

v.

THE McNAUGHTON GROUP, a Washington limited liability company,
and SILVER LAKE WATER AND SEWER DISTRICT,

Defendants-Respondents

ON APPEAL FROM SNOHOMISH COUNTY SUPERIOR COURT
(Hon. Linda C. Krese)

BRIEF OF APPELLANT

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I. INTRODUCTION

The McNaughton Group (“TMG”) borrowed more than \$11 million from Horizon Bank. The loan was secured by a deed of trust on a subdivision known as the Sommerwood Property. The deed of trust broadly defined Horizon Bank’s collateral to include not only the real estate, but also all “improvements and fixtures” on, and all “rights ... related to” or “benefits derived from,” the Sommerwood Property. TMG used the loan, in part, to finance construction of permanent sewer facilities on the Sommerwood Property that TMG later transferred—without notice to Horizon Bank—to Silver Lake Water and Sewer District (the “District”). In return for the transfer, TMG received a right to receive future “latecomers payments” from the District that would effectively reimburse TMG for the cost of constructing the sewer facilities.

TMG defaulted on the loan and Horizon Bank acquired the Sommerwood Property and all other collateral described in the deed of trust at a foreclosure sale. The sale still left a deficiency on the loan of more than \$6 million. Shortly thereafter, Washington Federal f/k/a Washington Federal Savings and Loan Association acquired all of Horizon Bank’s rights related to the Sommerwood Property, including the latecomers payments. But when Washington Federal asserted its right to the latecomers payments, TMG objected—insisting that the payments

were not part of the collateral described in the deed of trust and acquired by Horizon Bank at the foreclosure sale. The trial court agreed, and ruled in favor of TMG on the parties' cross-motions for summary judgment.

That ruling was erroneous and must be reversed. Horizon Bank had a valid security interest in the latecomers payments. *First*, the sewer facilities were "improvements and fixtures" and, thus, part of the bank's collateral. When TMG transferred that collateral, it received the latecomers payments in return. Because the payments are "proceeds" of the collateral, the bank's security interest automatically attached to them as well. *Second*, the latecomers payments are also "rights related to" and "benefits derived from" the Sommerwood Property because they arise directly from the use of the property as a site for the sewer facilities. Indeed, the payments are derived exclusively from fees paid by surrounding property owners who connect to and use the sewer facilities on the Sommerwood Property. *Third*, and for similar reasons, the latecomers payments are "profits" of the Sommerwood Property under real property law and, as such, were acquired by the bank at foreclosure.

In short, TMG owes more than \$6 million on the defaulted loan. The latecomers payments are part of the collateral that secured the loan and may be used to reduce that \$6 million deficiency. The trial court's ruling, unless reversed, would impermissibly allow TMG to shield the

bank's collateral from foreclosure through simple substitution—part of the Sommerwood Property (the sewer facilities) in exchange for a future revenue stream (the latecomers payments). That result is not only patently unfair, it is contrary to the unambiguous terms of the deed of trust, the Uniform Commercial Code (“UCC”) and applicable real property law.

II. ASSIGNMENTS OF ERROR AND STATEMENT OF ISSUES

The trial court erred when it (1) denied Washington Federal's first motion for summary judgment (CP 811-13), and (2) denied Washington Federal's second motion for summary judgment, granted TMG's cross-motion, and concluded that Washington Federal had no security interest in TMG's right to latecomers payments (CP 174-176). The issues raised by these related assignments of error are as follows:

1. The Deed of Trust granted Horizon Bank a security interest in all “improvements and fixtures” on the Sommerwood Property. Are the Sewer Facilities that TMG permanently annexed to the Sommerwood Property properly characterized as “improvements and fixtures”? **Yes.**

2. The UCC provides that a security interest in collateral automatically attaches to “proceeds” of the collateral. Is the right to latecomers payments TMG received upon transfer of the Sewer Facilities properly characterized as “proceeds” of the Sewer Facilities? **Yes.**

3. The Deed of Trust also granted Horizon Bank a security interest in all “rights ... related to” and “present and future ... revenues, income, ... and other benefits derived from” the Sommerwood Property. Is the right to latecomers payments properly characterized as “rights related to” or “benefits derived from” the Sommerwood Property? **Yes.**

4. The UCC provides that when a security agreement covers real and personal property, the creditor may proceed under applicable real estate law. Washington’s Deed of Trust Act provides that a non-judicial foreclosure transfers “all of the right, title, and interest in the real and personal property sold.” When Horizon Bank foreclosed on the Deed of Trust, did it acquire TMG’s right to latecomers payments? **Yes.**

5. Washington law defines “real property” to include future “rents and profits” of the property. Are the latecomers payments properly characterized as “profits” of the Sommerwood Property that Horizon Bank acquired at foreclosure? **Yes.**

III. STATEMENT OF THE CASE

A. TMG Enters Into Extension Agreements With The District To Construct Sewer Facilities On The Sommerwood Property.

Beginning in 2003, TMG began acquiring real estate in Snohomish County to develop residential subdivisions, one of which would become known as the “Sommerwood Property.” CP 940 (McNaughton Decl.,

¶ 2); CP 448 (McNaughton Depo at 448). To obtain approval of its development plans, TMG had to ensure that proper sewer facilities would be available to serve the Sommerwood Property and surrounding subdivisions. CP 501 (Curran Depo at 12); CP 485-86 (Giddings Depo at 162-63). So, on April 16, 2003 and again on July 14, 2006, TMG and the Silver Lake Water and Sewer District entered into developer extension agreements (“Extension Agreements”), pursuant to which TMG agreed to construct a sewer lift station and related improvements (the “Sewer Facilities”) on the Sommerwood Property. CP 328-39; CP 341-55.¹

The Extension Agreements provided that, once the Sewer Facilities were built, TMG would transfer the Sewer Facilities to the District. CP 347 (§ 5(e)); *also* RCW 57.22.010(3). Under the agreements, TMG agreed to construct the Sewer Facilities on the Sommerwood Property, but could later request reimbursement of its costs from the District through what is known as a “latecomers agreement.” CP 351 (§ 18); CP 502-03 (Curran Depo at 14-15). Latecomers agreements are authorized by RCW 57.22 *et seq.* Under such an agreement, a property owner who constructs

¹ The two Extension Agreements are nearly identical but contain different descriptions of the facilities to be built. The District’s position, which TMG did not dispute, was that both agreements were in effect at the same time. CP 508-09 (Curran Depo at 39, 41). Thus, it was of no consequence to the District that TMG indicated its desire for a latecomers agreement in the 2003 agreement but not in the 2006 agreement. CP 510-11 (*id.* at 42-43).

a sewer facility, and then transfers the facility to the district, is entitled to reimbursement from connection charges paid to the district by other property owners who use the facility. RCW 57.22.020(1).

B. Horizon Bank Loans TMG \$11,700,000 Secured By A Deed Of Trust On All Rights Related To The Sommerwood Property.

On March 3, 2005, TMG and Horizon Bank entered into a Business Loan Agreement in the amount of \$7 million (the “Loan”). CP 1253-57 (loan agreement); CP 491 (Buss Depo at 41). The Loan amount was ultimately increased to \$11,700,000 and, on November 28, 2007, TMG executed a Promissory Note to Horizon Bank in that amount. CP 1259-63 (modification agreements); CP 1265-66 (promissory note); CP 492-93 (Buss Depo at 44-45). The Loan and Note were secured by a Construction Deed of Trust (the “Deed of Trust”), dated March 15, 2007, in which TMG granted Horizon Bank and its successors a security interest in the Sommerwood Property. CP 1269-77 (deed of trust).²

The scope of the collateral described in the Deed of Trust, and whether it includes future payments under a “latecomers agreement,” is the central issue in this appeal. The Deed of Trust stated in relevant part:

² The Loan was originally secured by another property owned by TMG. CP 450-51 (McNaughton Depo at 79-80). Horizon Bank agreed to substitute that property with the Sommerwood Property in February 2007, prior to execution of the Deed of Trust. CP 493 (Buss Depo at 45).

... Grantor conveys to Trustee ... for the benefit of Lender as Beneficiary, all of Grantor's right, title, and interest in and to the following described real property, including all existing or subsequently erected or affixed buildings, improvements and fixtures; ... and all other rights, royalties, and profits relating to the real property ...

CP 1269. The Deed of Trust also included "all of [TMG's] right, title, and interest in and to all ... Rents ... of the Property," with "Rents" defined as "all present and future rents, revenues, income, issues, royalties, profits, and other benefits derived from the Property." CP 1269, 1275. The Deed of Trust was amended several times to reflect the increasing amount of the Loan, but without change to the definition of the collateral. CP 1279-89.

The parties did not negotiate the specific terms of the Deed of Trust, which was a form document. CP 946 (McNaughton Decl., ¶ 14). Thus, there were no discussions about whether the Deed of Trust covered rights that might arise out of the Sommerwood Property in the future, such as a right to payment under a latecomers agreement. CP 807 (Buss Decl., ¶ 7).³ Indeed, there was no reason to—the "as is" undeveloped value of the land was sufficient to secure the total amount of the Loan at the time of origination. CP 618-19 (Hall Depo at 17-18). The Horizon Bank

³ No one at TMG informed Horizon Bank that it was building the Sewer Facilities, much less that it did so contemplating that it would later receive payments under a latecomers agreement. CP 625 (Hall Depo at 31). Not surprisingly, then, at the time the Deed of Trust was signed, Horizon Bank could not have known that latecomers payments were part of collateral defined by the Deed of Trust. *Id.*

officer in charge testified, however, that the broad language of the Deed of Trust was intended to “obtain or maintain as much collateral value as the bank could,” including future improvements to the land. CP 529, 532-33 (*id.* at 36, 39-40).

C. TMG Constructs The Sewer Facilities, Which Are Permanent And Valuable Improvements To The Sommerwood Property.

In 2007, TMG began building the Sewer Facilities on and under the Sommerwood Property. CP 461 (McNaughton Depo at 148). The Sewer Facilities include a lift station, a master meter, sewer “force” main and gravity piping, as well as a parking area and fencing. The main component of the lift station is a wet well, which is essentially a concrete-lined manhole approximately 20 to 30 feet deep in the ground. Sewage from surrounding subdivisions flows by gravity into the well through underground piping; once there, pumps force the sewage into the force main. CP 465-66 (Giddings Depo at 59-60); CP 512 (Curran Depo at 52). The pumps are powered by electric motors that are bolted to a 12-inch thick concrete slab positioned at the surface of the well. CP 467-68 (Giddings Depo at 61-62); CP 514 (Curran Depo at 54). There is no way to effectively remove the wet well from the Sommerwood Property. CP 483-84 (Giddings Depo at 160-61); CP 512 (Curran Depo at 52).

The master meter is located in a six-foot deep covered concrete vault located next to the wet well. The meter controls water conveyed from the Alderwood Water and Sewer District to the District. A twelve-inch diameter water pipe, which is separate from the sewer main piping, runs to and from the master meter. CP 470-72 (Giddings Depo at 66-68). Finally, in the event of a power failure, the lift station is equipped with a five-by-ten foot diesel generator to provide back-up power. The generator cannot be removed without the use of a crane. CP 468 (*id.* at 62). The generator is connected by underground lines to a 550-gallon diesel fuel tank. Like the electric pumps, both the generator and the tank are bolted to a concrete slab. CP 468-67, 476 (*id.* at 62-63, 104).

The Sewer Facilities are valuable to the Sommerwood Property, not only because they provide sewer access to homeowners, but because installation of the facilities was a prerequisite to the county's plat approval for the Sommerwood Property. CP 480, 485-86 (Giddings Depo at 108, 162-63); CP 501 (Curran Depo at 12). Simply put, the Sommerwood Property could not have been developed without the Sewer Facilities. CP 480, 485 (Giddings Depo at 108, 162); CP 512 (Curran Depo at 52); CP 341-55 (extension agreement). By the same token, although a significant portion of the main and piping extend beyond the property, they have no use, and could not function as a sewer system, without the lift station and

main located on and under the Sommerwood Property itself. CP 475, 477, 480 (Giddings at 72, 105, 108); CP 510, 512-13 (Curran at 42, 52-53). The District does not believe that it is economically or geographically feasible to relocate the Sewer Facilities to another site. CP 512, 520-21 (Curran Depo at 52, 86-87).

D. TMG Transfers The Sewer Facilities To The District “Free Of All Liens” Notwithstanding The Senior Deed Of Trust.

Following completion of the Sewer Facilities, on February 26, 2009, without notice to or approval from Horizon Bank, TMG purported to transfer the facilities to the District by “Bill of Sale.” CP 363-65; CP 539 (Hall Depo at 50). Notwithstanding the Deed of Trust—which expressly covered all existing and future “improvements and fixtures” on the Sommerwood Property—the Bill of Sale stated that the Sewer Facilities were “free of all liens or encumbrances” CP 363. On May 6, 2009, also without notice to Horizon Bank, TMG granted the District a permanent site easement “over, across, through and under” the Sommerwood Property, giving the District a “perpetual right” to enter and excavate the land “to construct, maintain, repair and operate” the Sewer Facilities. CP 367-72. TMG made the transfers expecting that it would later receive a latecomers agreement from the District for reimbursement of its construction costs, which it did. CP 481 (Giddings Depo at 143).

E. TMG Defaults On The Loan And Horizon Bank Forecloses On All Rights Related To The Sommerwood Property.

By April 2009, TMG had been in default on the Loan for six months. CP 1291-96. In June 2009, Horizon Bank notified TMG that, unless the default was cured, the Sommerwood Property would be subject to non-judicial foreclosure. CP 1301-08 (notice of trustee's sale). The Notice of Trustee's Sale informed TMG that the foreclosure sale would include all real and personal property described in the Deed of Trust. CP 1301. TMG did not cure the default, and Horizon Bank purchased the Sommerwood Property at public auction on September 18, 2009. CP 1310-14. The trustee conveyed the Sommerwood Property to Horizon Bank by Trustee's Deed. *Id.* Following the foreclosure, TMG continued to owe Horizon Bank more than \$6 million on the Loan. CP 439.

F. TMG Signs A Latecomers Agreement With The District After Its Rights In The Sommerwood Property Were Foreclosed.

On October 7, 2009, six months after TMG purported to transfer the Sewer Facilities to the District and just weeks after its ownership of the Sommerwood Property was foreclosed, TMG and the District entered into a "Latecomers Agreement." CP 381-408. Under the agreement, the District agreed to pay TMG an amount equivalent to the cost of constructing the Sewer Facilities. The payments would come from fees that the District would charge property owners who connected to and used

the facilities. *Id.* The District's board of commissioners did not ratify the Latecomers Agreement until November 2010. CP 418-27.⁴ The District acknowledged that it would not have entered into the Latecomers Agreement had TMG not transferred the Sewer Facilities to it. CP 412.

G. The Trial Court Concludes On Summary Judgment That Washington Federal Has No Security Interest In The Payments TMG Will Receive Under The Latecomers Agreement.

On January 8, 2010, regulators closed Horizon Bank and named the FDIC as the bank's receiver. Washington Federal thereafter purchased certain assets of Horizon Bank from the FDIC, including all rights related to the Sommerwood Property. CP 1316-36. On December 30, 2010, Washington Federal brought this declaratory relief action against TMG and the District.⁵ Washington Federal sought a determination that payments made by the District under the Latecomers Agreements now belonged to it by virtue of Horizon Bank's foreclosure on the real and personal property described in the Deed of Trust. CP 1396-1427.

⁴ By this time, Horizon Bank (and later Washington Federal) had discovered that TMG was seeking a latecomers agreement, and notified the District that the bank acquired any rights TMG had under such an agreement. CP 429-30. TMG, however, continued to assert those rights on behalf of itself. CP 432-34. In an effort to protect itself against TMG's creditors or assignees, in June 2010, Washington Federal filed a UCC financing statement that identified all rights related to the Sommerwood Property, including rights in the Latecomers Agreement. CP 675-76.

⁵ Washington Federal sold the Sommerwood Property to a third party in 2011, but it expressly reserved to itself "any rights to payment related to the Latecomer's Agreement or Sewer Station." CP 249-62.

Washington Federal moved for summary judgment. CP 1337-61. TMG initially requested, and received, a CR 56(f) continuance. CP 1124-33; CP 1070-71. Later, TMG opposed Washington Federal's motion, primarily on the grounds that there were material issues of fact as to whether TMG and Horizon Bank intended the Deed of Trust to grant Horizon Bank a security interest in the right to payments under a latecomers agreement. CP 1036-69. The trial court agreed and denied Washington Federal's motion for summary judgment. CP 811-13.

Following discovery, the parties cross-moved for summary judgment. CP 542-64; CP 789-804. Both parties agreed that there were no disputed issues of fact, and each asked for judgment as a matter of law. The trial court granted TMG's motion and denied Washington Federal's, concluding that "Washington Federal ... has no security interest or other claim to the Latecomers' Fees that [TMG] is entitled to receive under its Latecomer's Agreement with Defendant Silver Lake Water and Sewer District." CP 174-76. Washington Federal timely appealed. CP 44-51.

IV. ARGUMENT

A. The Standard of Review Is *De Novo*.

This Court reviews summary judgment *de novo*, engaging in the same inquiry as the trial court and viewing the facts and all reasonable inferences in the light most favorable to the nonmoving party. *Hearst*

Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 501, 115 P.3d 262 (2005). Summary judgment is proper if the pleadings, depositions, answers to interrogatories, admissions, and affidavits show that there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. CR 56(c); *Hearst*, 154 Wn.2d at 501.

B. The Deed Of Trust Granted Horizon Bank A Security Interest In The Right To Latecomers Payments Under Article 9 Of The UCC; Horizon Bank Acquired That Right By Foreclosure.

Article 9 of the UCC governs security interests in personal property and fixtures. The Deed of Trust granted Horizon Bank a security interest in TMG's right to latecomers payments as a matter of law because those payments were (1) "proceeds" of TMG's disposition of "improvements and fixtures" on the Sommerwood Property, and (2) "rights ... related to" and "present and future ... revenues, income, issues, ... and other benefits derived from" the Sommerwood Property. Horizon Bank acquired the latecomers payments when it foreclosed on the Deed of Trust. Those payments now belong to Washington Federal.

1. The Right To Latecomers Payments Is A Proceed Of Collateral Described In The Deed Of Trust.

The Deed of Trust granted Horizon Bank a security interest in all "improvements" to and "fixtures" on the Sommerwood Property. The Sewer Facilities are both improvements and fixtures. Under the UCC, a security interest *automatically* attaches to all "proceeds" of collateral.

Because the right to receive latecomers payments is a direct result of TMG's transfer of the Sewer Facilities, the latecomers payments are proceeds—and, thus, collateral—within the scope of the Deed of Trust.

a. The Sewer Facilities Are “Improvements And Fixtures” Covered By The Deed Of Trust.

The Deed of Trust is a security agreement. A “security agreement is an agreement between the debtor and the lender that certain property will stand as collateral for the loan.” *Parker Roofing Co. v. Pacific First Fed. Sav. Bank*, 59 Wn. App. 151, 156, 796 P.2d 732 (1990). Under Article 9 of the UCC, a lender obtains a security interest in the debtor's personal property and fixtures when the debtor signs a security agreement describing the collateral, the lender gives value, and the debtor has rights in the collateral. RCW 62A.9A-109(a)(1); RCW 62A.9A-203(b). The security agreement does not need to be precise; a description of “property is sufficient, whether or not it is specific, if it reasonably identifies what is described.” RCW 62A.9A-108(a). Parties may describe collateral by category, type (such as “fixtures”) or “any other method, if the identity of the collateral is objectively determinable.” RCW 62A.9A-108(b)

The Deed of Trust must be interpreted like any other contract. *Parker Roofing*, 59 Wn. App. at 155. Thus, this Court should focus on the “objective manifestations of the agreement, rather than on the unexpressed

subjective intent of the parties,” giving its terms their ordinary, usual and popular meaning. *Hearst*, 154 Wn.2d at 503. The Deed of Trust reasonably and objectively identifies the collateral to include, among other things, all “right, title and interest in ... all existing or subsequently erected ... *improvements and fixtures*” on the Sommerwood Property. CP 1269 (emphasis added). As explained below, the Sewer Facilities are both improvements and fixtures and, as such, part of Horizon Bank’s collateral.

Improvements. The Sewer Facilities are “improvements” within the ordinary meaning of the term. An “improvement” is a broader concept than a “fixture.” *Pinneo v. Stevens Pass, Inc.*, 14 Wn. App. 848, 851, 545 P.2d 1207 (1976). An improvement encompasses any “valuable addition made to property ... intended to enhance its value, beauty or utility or to adapt it for new or further purposes.” *Burgeson v. Columbia Producers, Inc.*, 60 Wn. App. 363, 367, 803 P.3d 838 (1991) (quoting Black’s Law Dictionary 682 (5th rev. ed. 1979)). Not surprisingly, Washington courts have long considered wells, pumps and pipes associated with water/sewer facilities to be “improvements.” *Id.*; *Estate of Haselwood v. Bremerton Ice Arena, Inc.*, 166 Wn.2d 489, 210 P.3d 308 (2009); *Stuchell v. Mortland*, 8 Wn. App. 884, 509 P.2d 770 (1973). Indeed, the statute

authorizing latecomers agreements refers to privately developed water-sewer facilities as “improvements.” RCW 57.22.040(1).⁶

It cannot be disputed that the Sewer Facilities are a “valuable addition” to the Sommerwood Property that were intended to, and did in fact, “enhance its value ... adapt it for new and further purposes.” *Burgeson*, 60 Wn. App. at 367. Of course, the Sewer Facilities had intrinsic value in their own right. TMG’s marketing materials valued the lift station alone at \$3 million. CP 534-35 (Hall Depo at 43-44); CP 375. But more than that, the facilities increased the value of the land for its use as a residential subdivision. Before the Sewer Facilities, the Sommerwood Property lacked a sewer infrastructure to support residential housing. The Sewer Facilities brought that infrastructure to the land, enabled TMG to obtain approval for its development plans and, ultimately, provided lot owners with water and sewer service. CP 480, 485-86 (Giddings Depo at 108, 162-63); CP 501, 512 (Curran Depo at 12, 52). Indeed, when it ratified the Latecomers Agreement, the District expressly and correctly characterized the facilities as “improvements and betterments.” CP 419.

⁶ The Deed of Trust expressly defines “improvements” to include “all existing *and future improvements.*” CP 1274 (emphasis added). The UCC specifically permits this kind of after-acquired collateral clause. See RCW 62A.9A-204(a). Thus, even though the Sewer Facilities were not completed when the Deed of Trust was signed, Horizon Bank’s security interest attached to the facilities upon their completion.

Fixtures. The Sewer Facilities are also “fixtures” under the accepted common law definition of that term. Personal property becomes a fixture if (1) it is actually annexed to the realty, (2) its use or purpose is adapted to or integrated with the use of the realty, and (3) the annexing party intended a permanent addition to the realty. See *Dep’t of Revenue v. Boeing Co.*, 85 Wn.2d 663, 667-68, 538 P.2d 505 (1975). Intent is the most important factor, and must be determined from the circumstances surrounding annexation, including the nature of the article, the annexor’s relation to the land, the manner of annexation, and the purpose for which it was made. See *Western Ag. Land Partners v. Dep’t of Rev.*, 43 Wn. App. 167, 173, 716 P.2d 310 (1986). This common law test applies to determine whether an item is a “fixture” under the UCC. RCW 62A.9A-102(41); *In re Logan*, 195 B.R. 769, 772 (Bankr.E.D.Wash. 1996).

The Sewer Facilities are plainly “annexed” to the Sommerwood Property. Annexation exists where an item is “attached to the real estate as firmly as it appears to have been reasonably possible to attach it.” *Strong v. Sunset Copper Co.*, 9 Wn.2d 214, 230, 114 P.2d 526 (1941). “[A]nnexation, is often considered in light of the actual relationship of the object to the realty—whether the article is ‘in use as an essential part’ of the overall use of the property.” *Western Ag.*, 43 Wn. App. at 172 (quotes and citation omitted). It is undisputed that the wet well, pumps,

mechanical and electrical equipment, master meter, and significant aspects of the force main and piping are all either embedded in the ground or physically bolted to concrete pads on the surface. CP 465-68, 470-72, 476 (Giddings Depo at 59-62, 66-68, 104); CP 512, 514 (Curran Depo at 52, 54). By virtue of their annexation, it is effectively impossible to remove or relocate the Sewer Facilities from the Sommerwood Property. CP 483-84 (Giddings Depo at 160-61); CP 512, 520 (Curran Depo at 52, 86).

Next, the Sewer Facilities are “adapted” to the Sommerwood Property. Adaptation occurs when an item becomes “an important or essential part of the land’s use or enjoyment.” 35A Am. Jur. 2d Fixtures § 11; *Reeder v. Smith*, 118 Wash. 505, 508, 203 Pac. 951 (1922) (item was “used in the actual operation of the mines” which “could not accomplished without these annexations”); *Western Ag*, 43 Wn. App. at 172-73 (item was “integral part of the irrigation system” and “indispensable part of the property because without irrigation, farming ... would be impossible”). The Sewer Facilities are an essential part of the Sommerwood Property because, as discussed above, without them, TMG would not have obtained plat approval, and the land could not have been developed for or used as a residential subdivision. CP 475, 480, 485-86 (Giddings Depo at 72, 108, 162-63); CP 501, 512-13 (Curran Depo at 12, 52-52). Critically, because

of the property's unique geography, the Sewer Facilities could not have been built on any other location. CP 520-21 (Curran Depo at 86-87).

Lastly, there can be no dispute that TMG intended annexation of the Sewer Facilities to be "permanent." *Boeing*, 85 Wn.2d at 668. "When a property owner attaches the article to the land he is rebuttably presumed to have annexed it with the intention of enriching the freehold." *Western Ag*, 43 Wn. App. at 173 (citations omitted). That presumption applies here and, just as important, none of the circumstances surrounding annexation suggest that TMG intended the Sewer Facilities to be only a "temporary" addition to the Sommerwood Property. On the contrary, TMG needed to construct permanent Sewer Facilities in order to gain plat approval and, ultimately, to develop a residential subdivision that it could sell. And, of course, as noted, the Sewer Facilities were built in such a way that they could not be removed from the Sommerwood Property without prohibitive cost *and* the loss of water-sewer service to the Sommerwood Property and surrounding lots. CP 510, 512, 520-21 (Curran Depo at 42, 52, 86-87).

The fact that RCW 57.22.010 and the Extension Agreements required TMG to eventually transfer title to the Sewer Facilities to the District does not make their annexation any less permanent. The issue is whether TMG intended the Sewer Facilities to become a "permanent" addition to the land, not whether it intended to permanently retain title to

the facilities. Characterization or transfer of an item, pursuant to a bill of sale or otherwise, does not change its character as a fixture. *Courtright Cattle Co. v. Dolsen Co.*, 94 Wn.2d 645, 619 P.2d 344 (1980); *Oden v. City of Seattle*, 72 Wn.2d 221, 432 P.2d 642 (1967). Indeed, in *Oden*, the Supreme Court agreed that underground water pipes were fixtures—even though the owner transferred title to the city by “bill of sale.” *Id.* If anything, TMG’s retention of its fee ownership of the underlying real estate and transfer of the Sewer Facilities to the District for its long-term public use only confirms the permanence of the annexation.⁷ In sum, the Sewer Facilities are both improvements and fixtures.

b. The Right To Receive Latecomers Payments Are Proceeds Of The Sewer Facilities.

Because they were expressly identified in the Deed of Trust, Horizon Bank had an enforceable security interest in the Sewer Facilities once they were completed. RCW 62A.9A-203(b). The security interest in that valuable collateral did not evaporate when TMG transferred the Sewer Facilities to the District. RCW 62A.9A-205(a)(1)(A) (“security agreement is not invalid where “debtor has the right or ability to ... dispose of all or

⁷ Washington courts routinely find that pipes, mains and lines are fixtures when installed or embedded in buildings or the ground. See *United Mut. Sav. Bank v. Riebli*, 55 Wn. 2d 816, 350 P.2d 651 (1960); *Parrish v. Southwest Wash. Prod. Credit Ass’n*, 41 Wn.2d 586, 250 P.2d 973 (1952); *American Radiator Co. v. Pendleton*, 62 Wash. 56, 112 P. 1117 (1911); *Filley v. Christopher*, 39 Wash. 22, 80 P. 834 (1905).

part of the collateral”). Rather, under Article 9, Horizon Bank’s interest *automatically* attached to any “identifiable proceeds” of that collateral. RCW 62A.9A-315(a)(2); RCW 62A.9A-203(f) (“[t]he attachment of a security interest in collateral gives the secured party the rights to proceeds”). Thus, if the rights to reimbursement under the Latecomers Agreement are proceeds from TMG’s transfer of the Sewer Facilities, then those rights were part of the collateral described in the Deed of Trust.

The rights to latecomers payments are “proceeds” of the Sewer Facilities. Article 9 defines proceeds broadly to include “[w]hatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral,” “[w]hatever is collected on ... collateral,” and “[r]ights arising out of collateral.” RCW 62A.9A-102(64)(A) - (C). The Supreme Court held that the broad definition of proceeds was “intended to ensure that the term will be all-encompassing and will be given a flexible and broad content,” and was “clearly intended to include more than the usual cash proceeds received in a normal sale of collateral.” *Western Farm Serv., Inc. v. Olsen*, 151 Wn.2d 645, 648-49, 90 P.3d 1053 (2004) (citing *Ranier Nat’l Bank v. Bachman*, 111 Wn.2d 298, 757 P.3d 979 (1988)) (quotes

omitted). In short, “the term ‘proceeds’ includes all economic components that go into the total amount received for the product.” *Id.* at 652.⁸

To be sure, TMG’s transfer of the Sewer Facilities to the District was a “disposition” of Horizon Bank’s collateral. It is equally clear that the latecomers payments were a valuable “economic component” TMG received from that disposition and/or a “right[] arising out of” the Sewer Facilities. State law and the Extension Agreements expressly conditioned TMG’s right to receive latecomers payments upon transfer of the Sewer Facilities. RCW 57.22.010(3); CP 347 (§ 5(e)). And, indeed, TMG constructed the Sewer Facilities expecting that, in return, it would receive latecomers payments. CP 481 (Giddings Depo at 143). That is precisely what TMG got. After the transfer, the District signed and ratified the Latecomers Agreement. CP 381-408; CP 418-27. Critically, the District admitted that it would not have signed the agreement, and TMG would not have receive latecomers payments, but for the transfer. CP 412. Thus, the right to latecomers payments arose directly and exclusively from TMG’s construction *and disposition* of Horizon Bank’s collateral.

⁸ Notably, *Western Farm Service* and its antecedents construed the definition of “proceeds” in the prior version of Washington’s UCC. The current 2003 version broadened the definition of “proceeds” even further to include “[w]hatever is collected on, or distributed on account of, collateral” and “rights arising out of collateral.” See RCW 62A.9A-102, cmt. 13 (“The revised definition of ‘proceeds’ expands the definition beyond that contained in former Section 9-306 ...”).

The Supreme Court's decision in *Ranier Nat'l Bank* is instructive. There, the bank's security agreement covered the debtor's "livestock"—and, more specifically, the debtor's cattle. 111 Wn.2d at 300-01. The debtor elected to participate in the federal Dairy Termination Program (DTP), through which he would receive payments from the government in the amount of \$672,914 in exchange for an agreement not to acquire any interest or participate in milk production for a period of five years. *Id.* at 300. The debtor's participation in the DTP also required him to sell his existing cattle at auction, which he did. *Id.* at 301. There was no dispute that the \$50,000 "slaughter value" the debtor received at auction were proceeds. *Id.* Rather, the issue was whether the debtor's right to receive \$672,914 in future DTP payments were also proceeds of the bank's collateral, *i.e.*, the debtor's cattle. *Id.* at 302. The Court answered that question in the affirmative, holding that the DTP payments easily fell within the "all-encompassing" definition of "proceeds." *Id.*

The Court reasoned that the UCC's broad definition of proceeds as "whatever" the debtor received for collateral must be given its ordinary meaning as found in the dictionary: "anything ... everything ... no matter what ... anything at all." *Id.* at 303 (citation omitted). Plainly, a right to DTP payments was *something* the debtor received upon disposition of the cattle. *Id.* By the same token, a right to latecomers payments is *something*

TMG received upon transfer of the Sewer Facilities. Notably, *Ranier* rejected the argument that DTP payments were not “proceeds” because they constituted “general intangibles”—a category of collateral not listed in the security agreement. As the Court noted, proceeds and general intangibles “are not mutually exclusive.” *Id.* at 307-08. Here too, the fact that the Deed of Trust does not mention “general intangibles” is simply irrelevant to the inexorable conclusion that TMG’s rights under the Latecomers Agreement were “proceeds” of the Sewer Facilities.

2. The Latecomers Payments Are Also Part Of Horizon Bank’s Security Interest In “Rights Relating To” And “Benefits Derived From” The Sommerwood Property.

The Deed of Trust contains other, equally applicable, terms that granted Horizon Bank a security interest in the latecomers payments. The Deed of Trust included all “rights, royalties, and profits relating to” and “present and future ... benefits derived from” the Sommerwood Property. CP 1269, 1275. The latecomers payments are “rights ... relating to” and “benefits derived from” the Sommerwood Property because they arise exclusively from, and are inextricably tied to, ownership of the land. Only “property owners” can enter into extension and latecomers agreements. RCW 57.22.010 & 020. As a result, it is undisputed that the latecomers payments (1) arose from TMG’s election to construct the Sewer Facilities on the Sommerwood Property; (2) were contingent upon TMG’s transfer

of the property to the District; and (3) will be derived from charges paid by other owners who “connect to or use the facilities” located on the Sommerwood Property. RCW 57.22.020(1). Simply put, without the Sommerwood Property, there would be no latecomers payments.

Not only is the language of the Deed of Trust sufficiently broad to encompass the latecomers payments, it is sufficiently specific. As noted, a description of collateral is adequate so long as it “reasonably identifies” the property. RCW 62.9A-108(a). The security agreement may identify the property by category, type or “any other method, if the identity of the collateral is objectively determinable.” RCW 62.9A-108(b). “No magic words or precise form are necessary to create or provide for a security interest so long as the minimum formal requirements of the [UCC] are met.” *In re Northview Corp.*, 130 B.R. 543, 547 (BAP 9th Cir. 1991); RCW 62.9A-108(a), cmt. 13 (“This section rejects any requirement that a description is insufficient unless it is exact and detailed.”). Only “supergeneric” descriptions—such as “all the debtor’s assets” or “all the debtor’s personal property”—are too vague. RCW 62.9A-108(c).

Here, the Deed of Trust “reasonably identifies” the collateral because, unlike a supergeneric description, the all “rights related to” and “benefits derived from” language specifically defines and limits the scope of the security interest to certain rights arising from a particular parcel of

real property. Courts routinely find deeds of trust containing similar language sufficient to create a security interest in income and accounts arising from mortgaged real property. *See, e.g., In re Northview*, 130 B.R. at 546-47 (“all income, rents, royalties, revenues, issues, profits, fees and other proceeds of the Trust Property” encompassed hotel revenues); *Great-West Life & Annuity Ass. Co. v. Parke Imperial Canton, Ltd.*, 177 B.R. 843, 856 (Bankr.N.D.Ohio 1994) (same for “rents, issues or profits”); *In re Schaumburg Hotel Owner Ltd. P’ship*, 1989 WL 359490, *10 (Bankr.N.D.Ill. Jan. 12, 1989) (same). This case is no different.⁹ The latecomers payments were subject to the Deed of Trust for this reason too.

3. Horizon Bank Acquired The Latecomers Payments When It Foreclosed On The Deed Of Trust.

Because TMG’s right to payment under the Latecomers Agreement was part of Horizon Bank’s collateral, the only remaining issue is whether Horizon Bank acquired that right when it foreclosed on the Deed of Trust. It did. When a security agreement covers personal and real property, the creditor may exercise its rights in the collateral under Article 9 or, “[a]s to both the personal property and the real property in accordance with the

⁹ As discussed in Section IV.C. below, for similar reasons, the payments may also be properly characterized as “rents and profits” of the Sommerwood Property under applicable real property law. Thus, even if this Court were to conclude that Article 9 did not apply to the latecomers payments, Horizon Bank still acquired TMG’s right to the latecomers payments when it foreclosed on the Sommerwood Property.

rights with respect to real property[.]” RCW 62A.9A-604(a). The same rule applies to fixtures. RCW 62A.9A-604(b). Thus, Horizon Bank was entitled to cause its trustee to non-judicially foreclose on the Sommerwood Property, as well as fixtures and personal property covered by the Deed of Trust, pursuant to the Deed of Trust Act, RCW 61.24 *et seq.* Indeed, the Act expressly states that “when a deed of trust encumbers both real and personal property, the trustee is authorized to sell ... the grantor’s interest in that real and personal property at a trustee’s sale.” RCW 61.24.020.

It was undisputed below that the foreclosure sale complied with the Deed of Trust Act. Horizon Bank was the successful bidder at the sale. CP 1312. As a matter of law, Horizon Bank acquired, and thus Washington Federal now owns, “all of the right, title, and interest in the real and personal property sold at the trustee’s sale which the grantor had or had the power to convey at the time of the execution of the deed of trust, and such as the grantor may have thereafter acquired.” RCW 61.24.050(1); *see Udall v. T.D. Escrow Serv. Inc.*, 159 Wn.2d 903, 154 P.3d 882 (2007) (describing the plain meaning of RCW 61.24.050). For all the reasons explained above, that “right, title, and interest” included TMG’s right to payments under the Latecomers Agreement—whether

characterized as “proceeds” of “improvements and fixtures” or as “rights ... related to” and “benefits derived from” the Sommerwood Property.¹⁰

This result makes sense. Horizon Bank loaned TMG more than \$11 million. TMG used the Loan, in part, to finance construction of the Sewer Facilities, which added significant value to Horizon Bank’s collateral; not only did the facilities allow TMG to pursue its development plans and increase the marketability of the Sommerwood Property, the lift station alone was worth \$3 million. When it transferred the Sewer Facilities to the District, TMG got significant value in return—*i.e.*, a right to latecomers payments—which likewise became part of the collateral that Horizon Bank acquired upon foreclosure. Any other result would permit TMG to use the Loan to add value to the bank’s collateral and then, upon default, remove that value from the reach of the bank’s security interest by virtue of its separate agreement with the District. Neither the broad scope of the Deed of Trust nor Article 9 of the UCC permit such a result.

¹⁰ TMG argued below that Horizon Bank did not actually acquire TMG’s right to latecomers payments because the trustee’s deed refers only to “real property.” This argument is a non-starter. In *Udall*, the Supreme Court held that the “trustee’s delivery of the deed to the purchaser is a ministerial act,” and that it is the trustee’s acceptance of the purchaser’s bid that finalizes the transaction. 159 Wn.2d at 911-12. Thus, even if the form of the deed were defective, it would not diminish the scope of the foreclosure sale—which is defined by the Deed of Trust and Notice of Trustee’s Sale. Here, the Notice of Trustee’s Sale stated: “If the Deed of Trust grants the Beneficiary security interests in personal property ... said personal property will be included in the Trustee’s Sale. CP 1301.

C. The Latecomers Payments Are Also “Rents And Profits” Of The Sommerwood Property; Horizon Bank Acquired Those Rents And Profits When It Foreclosed On The Real Property.

Even if this Court were to conclude that Horizon Bank’s security interest did not attach to TMG’s right to latecomers payment under Article 9 of the UCC, real property law compels the same result. In Washington, unpaid “rents and profits” are considered real property for purposes of a deed of trust. RCW 7.28.230(2); *Kezner v. Landover Corp.*, 87 Wn. App. 458, 464-65, 942 P.2d 1003 (1997). As a result, when a lender forecloses on a deed of trust, as Horizon Bank did here, the former owner’s interest in future rents and profits on the real estate are “part of the bundle of rights passed to the new owner upon foreclosure.” *Kezner*, 87 Wn. App. at 460, 465-67. In other words, when Horizon Bank foreclosed and acquired the Sommerwood Property pursuant to RCW 61.24.050(1), it also acquired all of TMG’s interest in unpaid “rents and profits.” *Id.*

RCW 7.28.230 does not define “rents and profits,” so the term must be given its ordinary meaning. *State v. Gonzalez*, 168 Wn.2d 256, 263, 226 P.3d 131 (when a term is undefined by statute, it should be given an “ordinary meaning, and the court may look to a dictionary for such meaning”). The term “profits” is defined broadly to mean any “benefit, advantage, or pecuniary gain accruing to the owner or occupant of land from its actual use.” *Great-West*, 177 B.R. at 852 (quoting Black’s Law

Dictionary 1090 (5th ed. 1979)); *Mid-City Hotel Assoc. v. Prudential Ins. Co.*, 114 B.R. 634, 641 (Bankr.D.Minn. 1990). For all the same reasons that latecomers payments are “rights ... related to” and “benefits derived from” the Sommerwood Property, they may also be properly characterized as “profits” of the land. As discussed above, latecomers payments are a “benefit, advantage, or pecuniary gain” that is exclusive to the “owner” of the land (*see* RCW 57.22.020), and that arise directly as a result of the owner’s use of the land as a site for water-sewer facilities. Washington Federal was entitled to summary judgment on this basis too.

V. CONCLUSION

For the reasons set forth above, there is no dispute that TMG’s right to payment under the Latecomers Agreement was collateral covered by the Deed of Trust that Horizon Bank acquired through foreclosure. That collateral now belongs to Washington Federal. The summary judgment in favor of TMG must be reversed, and the trial court instructed to enter summary judgment in favor of Washington Federal.

RESPECTFULLY SUBMITTED this 22nd day of October, 2012.

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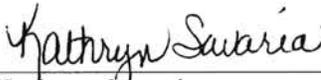
CERTIFICATE OF SERVICE

I hereby certify that on October 22, 2012, I caused to be served a copy of the foregoing **BRIEF OF APPELLANT** on the following person(s) in the manner indicated below at the following address(es):

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