## ORDERED ACCORDINGLY.

George B. Nielsen, Bankruptcy Judge

Dated: July 26, 2011

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In re:

WASHINGTON COAST I LLC, and

Debtors.

Plaintiffs,

Defendant.

PACIFIC CONTINENTAL BANK and

SONAS CAPITAL GROUP, LLC,

STRUCTURAL INVESTMENTS &

PLANNING IV LLC,

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RESOURCE FUNDING, INC., 18

v.

UNITED STATES BANKRUPTCY COURT

DISTRICT OF ARIZONA

Chapter 11 Case No. 2:08-18608-GBN Case No. 2:09-01035-RTB

(Jointly Administered)

Adversary No. 2:09-ap-00553

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

This adversary proceeding seeks to adjudicate the relative priority between creditors Pacific Continental Bank ("PCB") and Resource Funding, Inc. ("RF") regarding proceeds of real property sold by Washington Coast I, L.L.C. ("debtor"). The property, commonly referred to as the "Henningsgaard Parcel," is located in the state of Washington. On December 22, 2008, a voluntary Chapter 11 bankruptcy petition was filed by debtor in the District of Arizona. On January 22, 2009, a voluntary Chapter 11 petition was filed by Structural Investments &

Planning IV ("SIP IV") in Arizona, as well. The estates are jointly administered. During the course of the bankruptcies, the Henningsgaard parcel was sold by debtor for \$975,000. Future sales of other parcels may present similar disputes. The current sale proceeds are being held pending a determination of lien priority.

At the core of the dispute is a subordination agreement and its effect on PCB's senior security interest. The adversary was tried as a bench trial on December 17, 2010. Following closing arguments on March 8, 2011, the matter was taken under advisement. On June 30, 2011, an interim order was entered, advising the parties of the court's decision.

The court has considered sworn witness testimony, admitted exhibits, designated deposition transcripts, the joint pretrial statement and the facts and circumstances of this case. The following findings and conclusions are now entered:

## FINDINGS OF FACT

1. Between December 7, 2004 and March 29, 2006, Sonas Capital Group, L.L.C. ("Sonas"), entered into a series of loan transactions to lend funds to SIP IV and Pacific Crest I Development, L.L.C. ("Pacific Crest"). At least five promissory notes were secured by deeds of trust on realty owned by SIP IV and Pacific Crest, including parcels referred to as the Henningsgaard, Morse and Chelson parcels. The trust deeds were recorded in Pacific County, Washington in 2004 and 2005. Pursuant to a loan modification agreement dated December 19, 2006, Pacific Crest confirmed it transferred its interest in the

parcels to debtor. Joint Pretrial Order at pgs 1-3, adversary docket item ("dkt.") 100.

- 2. On September 28, 2005, Sonas and PCB executed a business loan whereby PCB extended a revolving line of credit to Sonas with a maximum principal amount of five million dollars, later increased to six million. Sonas entered into a commercial pledge agreement dated September 28, 2005, confirming that collateral for the Sonas loan included the Sonas trust deeds. The trust deeds were assigned to PCB by five separate assignments, recorded in Pacific County in July and September of 2005. On December 15, 2006, RF signed a five million-dollar trust deed installment note with debtor, SIP IV, Structural Investments, Inc., Donald Davis and Matthew Doney ("RF Note"). The RF Note is secured by a deed of trust on the parcels, as well as property in Salem, Oregon and was recorded on December 20, 2006. Id. at pgs. 3-4.
- 3. RF entered a subordination agreement with Sonas on December 20, 2006, that was recorded on the same date. PCB is not listed as a party in the subordination agreement and did not sign it. The five assignments, supra, were of record prior to the signing and recordation of the subordination agreement. RF had constructive notice of the assignments prior to signing the subordination agreement. RF did not contact PCB, either verbally or in writing regarding the assignments prior to signing the subordination agreement with Sonas. RF did not inform PCB verbally or in writing that it was entering into the Sonas subordination agreement. Bankruptcy sale proceeds are currently

held pending a determination of creditor lien priority in this adversary. A sale is also pending as to the Morse and Chelson Parcels. *Id.* at pgs. 4-5.

4. David Miller has been a PCB officer for nine years. His background includes 31 years experience handling bankruptcy cases, a Bachelor and Master degrees and a banking continuing education certification. Sonas functions as a real estate lender and held a secured credit line from PCB since late 2001. would examine Sonas' underwriting and submitted documentation. Mr. Miller's main Sonas contact was Dennis Lynch, an experienced land developer. Initially, PCB financed Sonas' condominium project, which went well. As a condominium unit was sold, PCB would execute a partial lien release through a title and trust company. Exhibit 66 relating to condominium unit 114 of Sonas' Phase II development, is an example of the parties' partial release procedure. This release document is dated December 27, 2006, although the loan was paid off in 2005. The release delay was caused by the requirement that PCB be paid in full first, ahead of other parties, before the trust deed is released. Admitted exhibits 64 through 84 are similar examples of partial PCB lien releases. Examples of somewhat different practices would include exhibit 85, a partial lien release on unit 229. Differences in this PCB release include that Mr. Miller signed the document and the fact it releases the bank's cash collateral interests. December 17, 2010 testimony ("test.") of David Miller.

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5. Admitted exhibit 50 is a March 4, 2010-title company letter requesting that PCB release trust deeds on several Phase II parcels for file correction purposes. Exhibit 61, an internal bank document, demonstrates the established practice involving six advances for which PCB had financed 80 per cent of the loan's face value. Exhibit 43 is a receipt, reflecting that PCB had taken physical possession of all original documents relating to a Phase III loan of more than two million dollars. Activity in the loan file indicates both a loan modification and an extension were granted. Although PCB was again an 80 per cent participant, it did not sign any of the modification or extension Instead, the bank controlled the process by documentation. taking physical possession of the material documentation and filing the trust deed assignment by Sonas. A spread sheet, exhibit 61, identifies ownership of various Phase III parcels, specifies unsold lots and lists recording dates of releases. Miller direct test.

6. Exhibit 45 at p. 575 reflects PCB and Sonas approval of a lien release for unit 228. Exhibit 40 is a September 28, 2005 loan agreement, reflecting PCB had conducted an annual review of the financial relationship since the 2001 inception of the loan. The page marked Exhibit A, titled "Proposed Lending Loan Purchase Guidelines" outlines lending standards, including that Sonas must maintain generally recognized, prudent underwriting parameters with conservative loan to value ratios. Standards include negative covenants not to sell or pledge PCB collateral interests and prohibition of

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assignments without the consent of PCB. Under the established practice, it was Sonas' responsibility to collect loan payments. The bank was to administer the loan only if Sonas fell into default. Mr. Miller identified exhibit 49 as a pledge agreement for a five million-dollar credit line, exhibit 38 as a recorded UCC continuation statement and exhibit 53 as a UCC financing statement by which the account debtor pledged collateral to Sonas. Exhibits 43 through 47 document that PCB maintained control of the Sonas loan by taking physical possession of the original pledge documents. Miller direct test.

- 7. Exhibit 41 is an amendment to a PCB loan to Sonas, executed on October 25, 2006. Exhibit ("ex.") 61 is a file analysis that discusses Sonas loans made to Matt Doney's limited liability companies, Pacific Crest and SIP IV. Secured loan number five was made to SIP IV on a Phase 3 real estate project as a secured transaction with a payoff balance as of December 12, 2006 of \$2,681,041.87. Mr. Miller recalls no substantive discussions regarding these transactions, except a brief mention that Matthew Doney was seeking loans from Lynch. The court finds this testimony credible. Miller direct test., Ex. 92 at p. 159.
- 8. The subordination agreement between RF, Pacific Crest, SIP IV, debtor and Sonas was notarized on December 19, 2006 and recorded in Pacific County, Washington on December 20, 2006. However, Mr. Miller did not see this document until April of 2010 while preparing for his deposition. He had heard about the subordination in early 2009, as Dennis Lynch was collecting Sonas loans. PCB was very concerned as an unauthorized

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subordination violated the express covenants between Sonas and the bank. In 2008, the Phase III collateral was in foreclosure due to Matt Doney's cost overruns and slow sales at the development. Sonas arranged for a receiver to take over. PCB was kept apprised of developments, but was not directly involved. It was Sonas' responsibility to collect the Doney notes. PCB had no relationship with Mr. Doney.

In 2008, the bank began to have difficulty obtaining information from Dennis Lynch. Accordingly, PCB began to review and occasionally audit Sonas loan files. Mr. Miller's email message of October 28, 2008 to Sonas associates David Fuhrer and Greg Daniels reflect frustration with Dennis Lynch. The October email seeks basic information on Sonas' collection of the Doney accounts, including date of granted extensions, date the receivership was instituted, the date the receiver took over, date foreclosure began, the process to be used in selling off the land and when the remaining nine units in Phase III could be expected to sell. There is no discussion in the document regarding the subordination, since Miller was not aware of it. When the email was answered, Miller learned for the first time than Sonas had placed a junior lien on collateral that was not immediately being foreclosed. PCB was concerned with Sonas collection activities as it was critical to repayment that Sonas would aggressively collect. The communication concludes: "Our credit is based on the idea you guys know what you're doing and you are decisive on problem loans." Ex. 48 at pgs. 912-13. court finds this witness testimony credible. Miller direct test.

9. On December 31, 2008, PCB unilaterally extended 2 Sonas note 52891 that had matured on November 1, 2008 to February 3 At this time the bank, concerned over the Sonas default, had frozen the credit line and increased the interest rate. When the note wasn't paid in February, the Sonas account 5 was designated delinquent in March of 2009. In January of 2009, 6 Miller learned from Dennis Lynch of the subordination<sup>1</sup>. 7 8 Miller known of the subordination at the time it was granted, he would have objected. Had the bank known of and approved the subordination, it would have insisted on use of its own standard 10 11 subordination documents and approval process through its own legal department. The witness had no discussions with RF and 12 13 denied giving Sonas authority to subordinate PCB collateral. The court finds this testimony credible. Ex. 8, Miller direct test. 14 15 10. Mr. Miller's responsibilities included monitoring

the adequacy of PCB collateral pledged by Sonas, since PCB would advance 80% of the proceeds Sonas lent. Using a form deed of trust assignment, Sonas would transfer its rights under the trust deed to PCB. As a layman, the witness did not know what, if any, collateral rights Sonas would retain after the assignment. In a September 2006 loan modification, Sonas agreed to increase the

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<sup>1</sup>The witness' testimony on direct was revised voluntarily upon presentation of his deposition transcript during cross examination, stating that the discovery date was the Fall of 2008. During redirect examination, the witness again revised the discovery date back to January of 2009. The court does not find these date lapses material. The court finds credible the witness' testimony that he was only aware of the subordination after the fact. Miller test., Ex. QQQ.

Doney loan by \$785,453. This modification, which Miller did not 1 2 sign and did not see, had the effect of impairing PCB collateral 3 by increasing the bank's exposure, in the witness' opinion. However, he conceded that if Sonas had not fully drawn on its PCB 4 credit line at the time of the Doney loan, this might not affect 5 6 the bank's lien priority. Sonas also agreed to a Doney loan 7 modification on December 19, 2006, the same date as the 8 subordination, in a document that references that a subordination has been given and includes a copy of it. Mr. Miller had no knowledge a PCB lien was purportedly being subordinated. 10 11 escrow was established by this modification, through which Doney granted encumbrances to Sonas, who then granted PCB a security 12 13 interest in the same encumbrances. PCB was not a party to the escrow or the escrow agreements. As collateral parcels were 14 15 sold, the bank would issue partial releases when it was paid. The witness estimated that Sonas owed the bank approximately \$4.2 16 17 million. The escrow proceeds for all three parcels would amount 18 to approximately \$3.7 million. The business loan required Dennis 19 R. Lynch to furnish his personal guarantee prior to disbursement 20 of the first loan proceeds. During the time Mr. Miller was responsible for the Sonas file, the Lynch personal guarantee was 21 22 not released. Miller cross test., Exs. KKK and LLL, Exs. R and 23 43 at p. 217, Ex. EE at pgs. 45-46, pgs. 52-61 and pgs. 63-76;

11. Miller informed Lynch that the subordination was a major problem, as it put a cloud on the PCB collateral. Although the witness testified at his deposition that he was

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Ex. 40 at p. 147.

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unaware of any written document that prohibited Sonas from subordinating PCB liens, at trial the witness now knows that is not correct. Although Miller felt he could legally place Sonas into default for the unauthorized subordination, he did not formally do so, since he had discovered the circumstances shortly before the upcoming February maturity date of the Sonas loan. Miller cross test.

lender chooses to modify the terms of its secured loans with clients. However, when Sonas records assignments of security to PCB, it is Mr. Miller's understanding that the bank's permission would be contractually required to subsequently release the assignment. On December 19, 2006, Sonas agreed to a loan modification with the Doney entities that subordinated an existing Sonas lien in favor of a new RF loan of five million. PCB is not a listed party, only Dennis R. Lynch and Matthew Doney are signatories. Had PCB been apprised of the agreement, it would have learned of the subordination. It was not so informed. Miller redirect test., Ex. EE.

13. In response to the court's questions, Miller testified that he first learned of the unauthorized subordination during a January 2009 meeting with Dennis Lynch. Lynch stated the subordination was not legally enforceable and should not be a concern. Upon receiving this information, Miller followed bank standard procedure by reporting the matter internally and commencing an investigation. The subordination was verbally reported to Credit Administration Officer Fred Holubak. Mr.

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Miller also talked to his superior, the bank area president and requested more information from Sonas, which was provided. also requested Sonas to provide the bank with additional collateral. However, before the additional collateral demand could be formally made, Sonas defaulted by failing to pay the loan at maturity.

It was rare for the bank to agree to a subordination. Mr. Miller does not recall ever agreeing to subordinate a commercial loan. Bank procedure would require a written proposal before any subordination would be allowed. The court finds this witness' testimony credible. Miller test.

14. Daniel L. Kerr, the secretary and treasurer of RF, testified it was his responsibility to collect and supervise the construction and commercial loans made by the company. never previously dealt with Matthew A. Doney. As RF Vice President, Kerr signed the November 14, 2006 offer to finance construction on Doney's South Salem subdivision. The witness made clear in a November 29, 2006-letter that RF would require a first lien position on the South Salem property, as well as on approximately 40 acres of beach front property in Washington. While the November offer was rejected, there was acceptance of a written RF offer of December 7, 2006 to loan Doney and Don Davis five million dollars to purchase the South Salem property. first lien position on the South Salem and beach front land was required. At this time, all the information RF had was an appraisal and a location on a map. RF did not engage an attorney to assist it in the five million dollar transaction. December 17, 2010 testimony (test.) of Daniel L. Kerr, Exs. 9, 10, Ex. X.

15. Upon personally reviewing а Transnation preliminary title report with an effective date of December 7, 2006, Mr. Kerr was concerned to learn of the preexisting Sonas liens and assignments to PCB for security. He discussed them with the title company, Doney and others, but had no discussions Doney suggested subordination by Sonas. agreed. He signed the subordination agreement, which was drafted by Sonas, the first time he saw it. He didn't understand the subordination to be limited and felt it clearly identified RF as the senior lender. The loan closed. On December 19, 2006, Mr. Kerr authorized two title companies to disburse loan proceeds, upon ensuring RF held first lien position on the South Salem property and additional acres in Seaview, Washington. The loan was funded. RF obtained a title policy insuring its first lien position. Kerr test., Ex. 14, Ex. 1, Exs. DD, BB, schedule B on p. 54.

loan. Mr. Kerr had an August 22, 2007 discussion with Dennis Lynch to notify Sonas of the Doney default. Prior to the Doney default, Kerr had no contact with PCB or Sonas. He was aware of the Sonas assignments prior to making the Doney loan by reviewing the Title report, but depended on the title company to obtain a first lien position for RF. The title policy RF received lists the Sonas assignments as an exception to coverage at Schedule B. Prior to the closing, Kerr became frustrated with the title

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company, which constantly assured him subordination of the assignments would be resolved. Mr. Kerr depended on the title company, not Sonas for the subordination. Neither PCB's name nor the Sonas assignments to PCB appeared in the subordination agreement. Mr. Kerr read the subordination agreement and noted that PCB and the assignments to it were not referenced. He did not contact PCB or Sonas before closing the loan. The court finds the witness' testimony to be credible. Kerr cross examination testimony ("cross"), Ex. 13 at P.473.

17. Matthew A. Doney, a licensed Arizona real estate agent, testified by designated deposition that he has 30 years experience in real estate development. He sold his interests in debtor and SIP IV to Sonas in May of 2009 and has no interest in the real property at issue in this case. He had no discussions with PCB and knew nothing of the terms of the arrangement between PCB and Sonas, other than that PCB was one of Sonas' lenders and that Sonas assigned its security interests to the bank. Doney's entities never had a direct loan relationship with PCB. At the time, Sonas was Doney's main source of funding. The witness dealt primarily with Dennis Lynch and occasionally with Paul Christensen of Sonas. Subsequently, Doney decided to invest in Salem, Oregon property and approached RF for funding the acquisition. The RF transaction was additionally collateralized by Doney's oceanfront property. To free the oceanfront property from Sonas liens, allowing RF the first lien position it demanded, Dennis Lynch suggested a subordination agreement.

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Designated deposition of Matthew A. Doney dated May 20, 2010 ("test.") at pgs. 18-77.

Doney left 18. it to Lynch to obtain the subordination, since only Lynch had the relationship with PCB. As the witness phrased it in regard to the senior PCB liens, "Well, that was his problem." Sonas received no consideration liens, subordinating its other than preserving relationship with Doney. In the witness' opinion, Sonas was "way over secured" by other collateral they held. He stated that "Dennis is a . . . liar." and characterized allegations as "a . . . lie" that Doney had conversations with Lynch regarding the terms to be utilized in subordinating PCB. The witness also denies being a party to discussions with Lynch regarding Lynch's subordination interactions with the bank or with Pacific County Title. He signed without reading the subordination agreement, prepared by Sonas' attorney David Weiner. He had no interactions with Kerr or anyone else with RF regarding the subordination. He advised Lynch what was demanded by Kerr in order to provide RF its first priority lien. It is likely he received a preliminary title report, but did not read it. He understood from Lynch that PCB authorized the subordination of its assigned Sonas liens. When Doney reviewed the title report at loan closing, the PCB liens were gone. He believes the consequences of the property's tainted title ruined him financially. Doney test. at pgs. 77-96.

19. The RF secured loan was acquisition financing. The subordination issue was first raised by Lynch in December of

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2006, probably at least two weeks before closing, as a way to provide RF a first lien. Had Lynch advised he could not obtain a PCB subordination, Doney would not have closed the RF loan. Prior to December 19, 2006, the date the RF loan documents were signed in Salem, up to four subordination agreement drafts had been in circulation. Based on conversations with Lynch, the signature witness felt а PCB was not required subordination and RF had been granted a first lien. closing, title officer Ms. Kathi Miller was angry with Lynch. The witness now speculates that Ms. Miller probably felt pressured at the time because of her concealed criminal activity. Doney instructed Lynch that a first priority lien had to be provided to RF and felt that Lynch could obtain the PCB subordination. He breezed through the Fidelity title report. Everything seemed to be in order. Subsequently, when in Salem, the witness asked for a copy of the Fidelity report and loan closing documents to include in his file. He observed a release signatory page for PCB and discovered the PCB senior liens remained on the property. Later at a meeting, he cursed Lynch and nearly struck him, when Lynch claimed Doney knew PCB's signature was required for the subordination. Doney never had a conversation with anyone at PCB regarding the dispute, as he had no relationships with the bank. Doney test. at pgs. 98-166.

20. Since the Doney testimony was provided only in the form of a deposition transcript, it is difficult for the fact finder to make a credibility determination. It is noted however, that his testimony is generally consistent with live testimony

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that this fact finder has found credible and persuasive. See Findings of Fact 4-13, supra.

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21. Dennis Lynch is a member of Sonas Capital, L.L.C.<sup>2</sup> and is responsible for underwriting, resolving and collecting loans made by this nonregulated commercial lending entity. Sonas made loans to Doney entities that were typically formed to acquire assets. Doney's loans would then be assigned to PCB as collateral for Sonas' credit line. The assignment would be of the promissory notes and loan documents of Sonas' commercial borrowers. Sonas' loans to its borrowers would be funded in an escrow. The title company had the responsibility to record the collateral assignment to PCB of the beneficial interest in the trust deeds. Sonas' members/partners all provided personal quarantees of the credit line to PCB. Although Sonas would deliver the original promissory note and trust deed to PCB and assign its beneficial interest to the bank, Sonas had the contract duty under the credit line to enforce and collect the commercial loans. In the witness' opinion3, Sonas could not sue its borrowers or seek a receivership without the joinder of PCB. Sonas made a number of loans to Doney to acquire and/or develop Pacific County property in the state of Washington. The loans

<sup>2</sup>Subsequently the witness self corrected that Sonas was a limited partnership whose managing partner was RealVest Corporation. Designated deposition of Dennis Lynch of April 27, 2010 ("test.") at pgs. 16-17.

 $<sup>{</sup>f 3}$  Since the designations do not clearly establish the witness' qualifications for this legal opinion, the fact finder will disregard it.

were cross collateralized by additional Doney property. Lynchtest. at pgs. 10-26.

22. There was an established process allowing partial reconveyances or releases of recorded Sonas trust deeds against Doney property, dictated by the title company and the property buyer's lender. The title company would prepare partial reconveyance forms for both Sonas and PCB, as both their liens The title company could not deliver an were of record. unencumbered title to the purchaser without both Sonas and PCB partially releasing their recorded liens. Mr. Lynch had no recollection of a PCB partial release occurring in which only Sonas signed. The witness had no contact with anyone from RF until after Doney's RF loan went into default. Prior to signing the subordination agreement, the witness had no contact with RF or PCB, but only dealt with Doney, Doney's son-in-law Don Davis and Sonas attorney David Weiner. He advised Doney that in his opinion a Sonas subordination by itself would not be effective. The witness refused to contact PCB regarding a subordination, because Sonas' commercial lending business was risky and Sonas wanted its lender bank to have a strong collateral position to avoid possible guaranty liability. Lynch test. at pgs. 28-59.

23. A few days after the Doney /Lynch conversations, a subordination agreement was delivered to Sonas. After initially refusing to sign, following negotiations between Sonas' attorney and RF Lynch signed the subordination. To his surprise, he later learned from Doney that the RF loan had closed with a first lien position granted without a bank subordination. He

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repeatedly contacted the title company, advising that their title report erroneously reflected the RF senior lien position without a PCB subordination. The title company refused to act. Lynch test. at pgs. 60-94.

24. Sonas filed receivership actions against Doney entities regarding default of the Sonas loans without naming PCB as a party. Regardless, in the witness' opinion, Sonas cannot take legal actions to enforce the trust deeds if PCB objects or without the bank being aware of the action<sup>4</sup>. Mr. Lynch is certain PCB was aware of two receivership actions filed by his entity against Doney entities, but cannot recall the manner in which PCB was given notice. A memorandum was sent to the bank on or after February of 2009. The witness cannot locate any reference in this memo that memorializes a discussion between PCB and Sonas that occurred before the subordination. He cannot recall any written or oral authorization from PCB that allows Sonas discretion to deal with the assigned collateral beyond what is granted in their written agreements. Lynch test. at pgs. 95-130.

25. Since the Lynch testimony was presented only in the form of a deposition transcript, it is difficult for the fact finder to make a credibility determination.

26. To the extent that any of the following conclusions of law should be considered findings of fact, they are hereby incorporated by reference.

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1. To the extent that any of the above findings of fact should be considered conclusions of law, they are hereby incorporated by reference.

2. Jurisdiction of these jointly administered Arizona Chapter 11 reorganization cases is vested in the United States District Court for the District of Arizona. 28 U.S.C. §1334(a). That court has referred all cases under Title 11 of the United States Code and all adversary proceedings and contested matters arising under Title 11, or related to a bankruptcy case to the United States Bankruptcy Court for the District of Arizona. 2.8 U.S.C. §157(a); District Court General Order 01-15(1). This adversary having been appropriately referred, this court has core bankruptcy jurisdiction to determine the validity, extent and priority of the parties' liens. 28 U.S.C. §157(b)(2)(K). party has questioned this court's jurisdiction. See dkt. 100 at ¶ II.

3. This court's conclusions of law are reviewed de novo. Its factual findings are reviewed for clear error. Hanf v. Summers (In re Summers), 332 F. 3d 1240, 1242 (9th Cir. 2003). Findings of fact, whether based on oral or documentary evidence will not be set aside unless clearly erroneous. Due regard is given to the opportunity of the bankruptcy court to judge the credibility of witnesses. Rule 8013, F.R.B.P. The appellate court accepts the bankruptcy court findings, unless upon review, it has the definite, firm conviction a mistake has been committed. Ganis Credit Corp. v. Anderson (In re Jan Weilert RV,

Inc.), 315 F. 3d 1192,1196 (9th Cir.), amended by 326 F. 3d 1028
(9th Cir. 2003).

4. Under Washington state law, a person who acquires an interest in real property with actual or constructive notice of the rights of another takes subject to the other's rights. Clare House Bungalow Homes Residents Association v. Clare House Bungalow Homes, L.L.C. (In re Clare House Bungalow Homes, L.L.C.), 447 B.R. 617, 622 (Bankr. E.D. Wash. 2011)(Prior unrecorded rights of occupancy prevail over a subsequent recorded lien when there is a duty to inquire). Here RF was clearly aware of the prior PCB lien position. A subsequent mortgagee takes subject to any prior encumbrances of which mortgagee has either actual or constructive knowledge. RCW 65.08.070, Kim v. Lee, 31 P. 3d 665, 668 (Wash. 2001)(citing cases). Recording of a prior property interest provides constructive notice of that interest. United Sav. and Loan Bank v. Pallis, 27 P.3d 629, 634 (Wash. App. Div. 1, 2001). Since the PCB collateral interests are clearly recorded prior to plaintiff's lien, RF can only prevail by establishing an equitable theory that would allow the court to disregard the bank's prior position. RF has not done so.

5. Under Washington law, equitable estoppel is not favored. The party asserting estoppel must prove each of its elements by clear, cogent and convincing evidence. The elements required to be proven are: (1) an admission, statement or act inconsistent with a claim of priority; (2) action by another in reasonable reliance on that act, statement or admission and (3) injury to the party who relied, if the court allows the acting

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party to contradict or repudiate the prior act. *Peterson v. Groves*, 44 P.3d 894, 896 (Wash. App. Div. 1, 2002)(citing cases). There is no act or statement by PCB in the record inconsistent with its claim of priority. Findings, supra at ¶ 4-13. Nor does RF purport to rely on any such direct act by the bank. *Id.* at ¶ 3, 9, 12, 15-16. Rather, defendant argues agency theories allow priority over the bank. This court disagrees.

6. An agent's authority to bind his principal may be actual or apparent. Actual authority may be express or implied. King v. Riveland, 886 P.2d 160, 165 (Wash. 1994). Both actual and apparent authority depend on objective manifestations made by the principal. With actual authority, the principal's objective manifestations are made to the agent. Id. With apparent authority, the objective manifestations are made to a third person. 886 P.2d at 165. When an agent has actual authority to act on behalf of the principal, the agent's exercise of the authority binds the principal. Blake Sand & Gravel, Inc. v. Saxon, 989 P. 2d 1178, 1181 (Wash. App.Div 2 1999). The court can find no facts in the record, either documentary, through the testimony of PCB, its alleged agent Sonas, or from RF, that Sonas had actual authority to subordinate the bank's lien position. The alleged agent release of the senior lien position would be at odds with PCB's normal lien release procedures. Findings, supra. at ¶4, 6, 8, 10, 13.

7. Implied authority is actual authority, circumstantially proved, that the principal actually intended the agent to possess.  $King\ v.\ Riveland$ , 886 P. 2d at 165. Implied

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actual authority depends on an objective manifestation from the principal to the agent. *Id*. A common example of implied actual authority occurs when the agent has consistently exercised a power not expressly granted to the agent and the principal, knowing this and making no objection, tacitly sanctions the practice. *Id*. This court can find no evidence of objective actions by the alleged agent of which PCB was aware, which constitutes implied actual authority to authorize subordination by Sonas without the knowledge or approval of PCB.

8. With apparent authority, objective manifestations are made by a principal to a third party. Such manifestations support a finding of apparent authority only if they have two effects. First, they must cause the party asserting apparent authority to actually believe the agent has such authority. Second, they must be of such significance that claimant's actual, subjective belief is objectively reasonable. King, supra at 165.

Apparent authority can be created by appointing an agent to a position, such as manager or treasurer, which carries generally recognized duties. To those who actually know of the principal's appointment, there is apparent authority to do that ordinarily entrusted to such a position, regardless of the unknown limitations the principal actually imposed on the agent. Id. However, while a principal's objective manifestations can cause one claiming apparent authority to actually or subjectively reasonably believe the agent has apparent authority, objective manifestations of authority by the alleged agent do not establish apparent authority. Ranger Ins. Co. v. Pierce County, 192 P.3d

886, 890-91 (Wash. 2008). Defendant's case for apparent authority fails on two counts: (1) RF never dealt with alleged principal PCB and (2) RF relied on the title company and not alleged agent Sonas to obtain the required first lien position. Findings, supra at  $\P$  3, 15-16.

9. RF has failed to establish an equitable estoppel theory available under Washington state law that would authorize the court to disregard the prior recordation of PCB's liens. Plaintiff PCB has established its case of first lien priority in the proceeds. These findings and conclusions establish the law of this case and will be followed by this court in similar lien disputes arising in these jointly administered cases that involve these parties and similar facts and law.

## ORDER

The court finds for plaintiff and Intervener plaintiff against defendant. Plaintiff's complaint and cause of action are sustained. Plaintiff will lodge and serve a proposed judgment. Defendant will have five days to object to its form.

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of July, 2011, to:

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