



Commercial Lending Law in Washington

by Brian D. Hulse

**COMMERCIAL LENDING LAW
IN WASHINGTON**

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COMMERCIAL LENDING LAW IN WASHINGTON

I. INTRODUCTION

This guide is intended to introduce lenders and lawyers to the general outline of the laws of the State of Washington that govern commercial lending, commercial real estate finance, equipment leasing and related areas. It does not deal with issues related specifically to consumer lending and finance, although certain issues and statutes related to those topics may be mentioned. Relatively detailed treatment is given to real estate lending issues because the law in the area is more state-specific than the law in the areas of personal property-secured lending and equipment leasing.

This guide assumes a basic working knowledge of financing transactions generally. It is, by nature, general in scope and meant as a brief overview of the subjects discussed. It should not be relied upon in a specific transaction without legal advice tailored to that transaction.

II. BASIC LEGAL STRUCTURE

A. Statutory Law – The Revised Code of Washington

The general law of Washington is found in the state Constitution and in the Revised Code of Washington (“RCW”). The RCW is divided into 91 Titles. Titles of particular interest to commercial lenders include the following:

- 6 Enforcement of Judgments
- 7 Special Proceedings and Actions (including receivership and replevin)
- 11 Probate and Trust Law
- 19 Business Regulations – Miscellaneous (including statute of frauds, fraudulent transfers, interest and usury, and consumer protection)
- 23B Washington Business Corporation Act
- 25 Partnerships (including limited liability companies)
- 26 Domestic Relations (including community property law)
- 30 Banks and Trust Companies
- 31 Miscellaneous Loan Agencies
- 32 Mutual Savings Banks
- 33 Savings and Loan Associations

- 46 Motor Vehicles
- 60 Liens (numerous statutory liens)
- 61 Mortgages, Deeds of Trust and Real Estate Contracts
- 62A Uniform Commercial Code
- 63 Personal Property
- 64 Real Property and Conveyances
- 65 Recording, Registration and Legal Publication
- 82 Excise Taxes

The full text of the RCW is available without charge on the state's website at <http://apps.leg.wa.gov/rcw/>.

B. Administrative Law

A number of state agencies have authority to promulgate regulations. They include the Department of Financial Institutions, the Department of Insurance, the Department of Ecology, and the Department of Revenue. Administrative regulations are first published in the Washington State Register and are periodically consolidated in the Washington Administrative Code (the "WAC"). The full text of the WAC is available without charge at <http://apps.leg.wa.gov/wac/>.

C. Local Law

Washington has 39 counties, each with its own ordinances.

D. Courts

The courts of primary jurisdiction in Washington are the superior courts of each county. In addition, each county has local district courts, municipal courts and small claims courts. The vast majority of actions by lenders to enforce repayment of commercial loans are brought in the superior courts. Judicial foreclosures of real property security instruments are almost always brought in the superior courts, as are actions for appointment of receivers.

The Washington Court of Appeals is the intermediate appellate court. It has three departments, which sit in Seattle, Tacoma and Spokane. The Washington Supreme Court is the state's highest court. It sits in the state capital, Olympia.

The federal courts in Washington are the United States District Court for the Western District of Washington and the United States District Court for the Eastern District of Washington. Washington is part of the Ninth Circuit Court of Appeals.

III. AUTHORITY TO DO BUSINESS AND TAXATION

A. Required Qualification to Do Business; Trade Names

Foreign corporations are prohibited from transacting business in Washington unless they properly qualify to do so. RCW 23B.15.010 sets out various examples of activities that do *not* constitute transacting business in the state in this context. They include:

- Making loans or creating or acquiring evidences of debt, mortgages, or liens on real or personal property, or recording same;
- Securing or collecting debts or enforcing mortgages and security interests in property securing the debts;
- Owning, without more, real or personal property;
- Conducting an isolated transaction that is completed within thirty days and that is not one in the course of repeated transactions of a like nature;
- Transacting business in interstate commerce;
- Maintaining or defending any action or suit or any administrative or arbitration proceeding, or effecting the settlement thereof or the settlement of claims or disputes;
- Maintaining bank accounts, share accounts in savings and loan associations, custodian or agency arrangements with a bank or trust company, or stock or bond brokerage accounts;
- Selling through independent contractors;
- Soliciting or procuring orders, whether by mail or through employees or agents or otherwise, where the orders require acceptance outside the state before becoming binding contracts and where the contracts do not involve any local performance other than delivery and installation; and
- Owning and controlling a subsidiary corporation incorporated in or transacting business within the state.

Limited liability companies, limited partnerships and limited liability partnerships organized under the laws of jurisdictions other than the State of Washington are subject to similar, but not identical, requirements under RCW 25.15.350 (limited liability companies), RCW 25.10.540 (limited partnerships) and RCW 25.05.565 (limited liability partnerships). The statute describing activities of a foreign limited liability partnership that do not constitute transacting business in Washington provides that “ownership in this state of income-producing real property or tangible personal property, other than [certain limited types of property],

constitutes transacting business in this state.” RCW 25.05.565(2). There are no requirements for a general partnership organized under the laws of a jurisdiction other than Washington to obtain a certificate of authority or otherwise qualify to transact business in the state.

To qualify to transact business in Washington, a foreign entity must make appropriate filings with the Washington Secretary of State, maintain a registered office in Washington (often with a professional corporate services company), and designate a registered agent for service of process in the state.

Individuals and all types of entities are required to register trade names under RCW chapter 19.80.

B. Licensing Requirements and Regulation of Financing

As a general rule, non-Washington based lenders and equipment lessors are not required to obtain licenses in order to engage in permissible commercial lending and leasing activities in Washington. There are certain exceptions and certain regulatory statutes of which lenders should be aware, including the following:

- Nondepository lenders participating in the U.S. Small Business Administration 7(a) loan guaranty program must be licensed under RCW chapter 31.40.
- Check cashers and sellers that are not financial institutions must be licensed under RCW chapter 31.45. Licensees that make loans of \$500 or less for 31 days or less must have a special small loan endorsement to their licenses. This endorsement is obtained by lenders commonly referred to as “payday lenders.”
- Insurance premium financiers must be licensed under RCW chapter 48.56.
- The Consumer Loan Act (RCW chapter 31.04) contains licensing requirements applicable to consumer lenders other than banks, savings institutions and credit unions.
- Financial institutions are subject to regulation under RCW titles 30 (banks and trust companies), 32 (mutual savings banks) and 33 (savings and loan associations).
- Credit unions are regulated under RCW chapter 31.12.
- Nondepository agricultural lenders participating in the farmers home administration loan guaranty program are regulated by the Washington Department of Financial Institutions pursuant to RCW chapter 31.25.
- Residential mortgage brokers must be licensed under RCW chapter 19.146.
- Retail installment sales of goods and services are regulated under RCW chapter 63.14.

- RCW chapters 19.148 and 19.149 require certain disclosures by servicers and lenders of real estate loans secured by one to four family properties.

C. Taxation

The principal Washington state taxes that out-of-state lenders and equipment lessors must be concerned with are the business and occupation tax (the “B&O Tax”), the retail sales tax, the real estate excise tax and the property tax. The application of these taxes to particular lenders or lessors is complex and should be considered in the context of a lender’s or lessor’s specific circumstances. Washington does not have a net income tax or a mortgage recording tax.

For information about the priority of tax liens as against other liens and security interests, see Section VII.C below.

1. Business and Occupation (“B&O”) Tax

The B&O Tax is a gross receipts tax and is generally in an amount of one and one-half percent of the taxpayer’s gross income. It is provided for in RCW chapter 82.04.

Special regulations for the B&O Tax as it relates to financial institutions are set out in WAC 458-20-146 and -14601.

Amounts derived from interest received on loans primarily secured by first mortgages or trust deeds on nontransient residential properties are not subject to the B&O Tax. RCW 82.04.4292. In this context, the term “nontransient residential properties” includes one to four family properties, apartments, long-term senior living facilities and construction loans for residential properties. Department of Revenue Excise Tax Advisory 460.04.146 (issued July 17, 1974); *Washington State Department of Revenue v. Security Pacific Bank of Washington National Association*, 109 Wash. App. 795, 38 P.3d 354 (2002). The *Security Pacific Bank* case also held that interest on a mortgage warehouse loan to a mortgage lender is eligible for the exemption to the extent the loan is secured by mortgage loans that are in turn secured by first mortgages or deeds of trust on nontransient residential properties. *Id.*

2. Retail Sales Tax and Use Tax

The combined state and local retail sales tax provided for in RCW chapter 82.08 varies by locality, but is generally between seven and nine percent of the taxable sales price. The term “retail” sales tax is something of a misnomer because the tax applies to many services and other transactions that are not retail sales in the common sense of the word. Sales tax is not generally payable on interest income, but is often payable on lease payments under equipment leases. WAC 458-20-211. RCW chapter 82.08 contains a number of exemptions from the sales tax. There is no exemption for foreclosure sales under Article 9 of the Uniform Commercial Code, so the tax generally must be paid on such sales unless one of the other exemptions applies. One exemption that may apply to some Article 9 foreclosure sales is the “casual or isolated sale” exemption of RCW 82.08.0251, if the seller is not otherwise engaged in a business activity taxable under the B&O Tax. See WAC 458-20-106. However, while that exemption may

excuse the seller from the duty of collecting the sales tax, it does not excuse the buyer from any applicable obligation to pay the compensating use tax described below. RCW 82.08.0251.

Washington's retail sales tax, which is collected by the seller, is a trust fund tax. RCW 82.08.050. Therefore, an Article 9 security interest in a borrower's accounts receivable does not attach to the portion of the account that represents the sales tax and asset-based lenders should be careful to exclude sales tax from the class of eligible receivables against which they will make advances.

Washington also has a compensating use tax, which applies to the use in the state of certain items on which sales tax has not been paid. It is provided for in RCW chapter 82.12.

3. Real Estate Excise Tax

Washington has a real estate excise tax, which is payable upon any sale of real estate and upon the sale of a controlling interest in a corporation, limited liability company, partnership or other entity owning real estate in Washington. RCW 82.45.010 and WAC chapter 458-61A. The state rate is 1.28% of the "selling price." RCW 82.45.060. Local jurisdictions can impose additional amounts and the aggregate amount of the state and local tax can exceed 2% of the selling price.

The tax is the obligation of the seller and may be enforced by a lien on the property. RCW 82.45.070 and .080. It is payable at the time of the sale. RCW 82.45.100(1). In order to record a deed, a real estate excise tax affidavit providing the details of the sale and the amount of the tax must be filed with the deed. As a result, the purchase price of real estate is public information. The form of the affidavit can be obtained from the Washington Department of Revenue's website at www.dor.wa.gov.

The tax is not payable upon, among other things: (a) the recording of a deed of trust or mortgage; (b) foreclosure of a deed of trust or mortgage or forfeiture of a real estate contract; or (c) a deed in lieu of such a foreclosure or forfeiture. RCW 82.45.010(3)(h) and (i); WAC 458-61A-208.

The amount of any recourse debt on the transferred property assumed by the transferee is included in the selling price on which the real estate excise tax is calculated. WAC 458-61A-103(1). However, the tax "does not apply to transfers of real property subject to an underlying debt when the grantor has no personal liability for the debt and receives no other consideration for the transfer." WAC 458-61A-103(2).

The real estate excise tax does not apply to the conveyance of property by a trustee or debtor in possession under a confirmed chapter 11 or chapter 12 bankruptcy plan. WAC 458-61A-207(1). Nor does it apply to the typical judicial or nonjudicial foreclosure sale, deed in lieu of foreclosure, real estate contract forfeiture, or transfer of foreclosed property from a loan servicer to the owner of the foreclosed loan. WAC 458-61A-208. However, where a deed in lieu of foreclosure is given on a junior lien mortgage or deed of trust, the tax is payable on the outstanding principal amount of any senior lien that is not satisfied by the deed. WAC 458-61A-208(3)(d)(iii).

4. Property Taxes

Washington imposes property taxes on both real and personal property pursuant to RCW title 84. The lien for real property taxes attaches to the taxed property as of January 1 of the year immediately prior to the year in which the taxes are payable. RCW 84.60.020. The attachment of the lien for personal property taxes is provided for in RCW 84.60.020 and RCW 84.56.070. It has priority over all UCC Article 9 security interests in the taxed property. RCW 84.60.010. Real property tax bills are generally mailed to the taxpayer in January or early February of each year and are payable in two equal installments, which become delinquent if not paid by April 30 and October 31 of the same year. RCW 84.56.020. However, if the first installment is not paid by April 30, both installments become delinquent. *Id.*

IV. INTEREST AND USURY; PROMISSORY NOTES

A. Compound Interest

Compound interest is disfavored under Washington law and will not be permitted in the absence of an express agreement. *Goodwin v. Northwestern Mutual Life Insurance Company*, 196 Wash. 391, 402-03, 83 P.2d 231 (1938).

B. Usury

1. Business Purpose Exception

Usury is generally not a major concern for commercial lenders in Washington. Washington's usury statute is contained in RCW chapter 19.52. It provides that the defense of usury may not be pled "if the transaction was primarily for agricultural, commercial, investment, or business purposes" but that the usury limits do apply to a "consumer transaction" of any amount. RCW 19.52.080¹. "Consumer transaction" is defined in that section to mean a transaction "primarily for personal, family, or household purposes." A consumer transaction, even if it is very large in amount, is subject to the usury limitation². A lender is entitled to rely on the borrower's representations as to the use of the borrowed funds unless it has notice that the representations are false. *Castronuevo v. General Acceptance Corporation*, 79 Wash. App. 747, 751-52, 905 P.2d 387 (1995); *The Revocable Trust of Harold Strand v. Wel-Co. Group, Inc.*, 120 Wash. App. 828, 835, 86 P.3d 818 (2004). In order to take advantage of the business purpose exception, commercial loan documents should contain a representation along the lines of the following:

“[Borrower] represents and warrants to [Lender] that the loan or extension of credit provided for herein is made exclusively for agricultural, commercial,

¹ Although RCW 19.52.080 is not, by its terms applicable to limited liability companies, it is made applicable to them by RCW 1.16.080.

² The usury limit can be applicable to a loan of millions of dollars where, for example, the loan is for the purpose of constructing or buying a yacht or an aircraft for personal use or for the purpose of paying a marital dissolution settlement. There is, however, a federal statute that appears to preempt state usury laws for loans secured by preferred marine mortgages on federally-documented vessels. 46 U.S.C. § 31322(b).

investment or business purposes and no portion thereof shall be used for any consumer, personal, family or household purpose.”

A loan is not necessarily a business purpose loan simply because it is made to refinance all or part of a business purpose loan. *McGovern v. Smith*, 59 Wash. App. 721, 732, 801 P.2d 250 (1990); *but, see, Jansen v. Nu-West, Inc.*, 102 Wash. App. 432, 440, 6 P.3d 98 (2000) (“If the purpose of the loan is to pay off a previous loan, the purpose of which was primarily business, the purpose of the second loan is also primarily business.”). Such a refinancing loan is especially likely to be held not to be for a business purpose where there is no longer an ongoing business and the borrower of the refinance loan is using it to discharge his or her personal liability for the original loan.

2. Usury Limit Where Exception Does Not Apply

Where the usury limit applies, the maximum rate is “the higher of: (a) twelve percent per annum; or (b) four percentage points above the equivalent coupon issue yield (as published by the Board of Governors of the Federal Reserve System) of the average bill rate for twenty-six week treasury bills as determined at the first bill market auction conducted during the calendar month immediately preceding the later of (i) the establishment of the interest rate by written agreement of the parties to the contract, or (ii) any adjustment in the interest rate in the case of a written agreement permitting an adjustment in the interest rate.” RCW 19.52.020.

In addition to the general rules set forth above, RCW 19.52 contains a number of special rules and exceptions applicable to particular types of transactions and sets out penalties for violation of the usury limits.

It is a Class C felony “knowingly to collect any unlawful debt.” RCW 9A.82.045. An “unlawful debt” includes, among other things, one bearing interest at a rate at least twice the maximum permitted rate under applicable state or federal law. RCW 9A.82.010(21).

Washington’s usury limit is applicable to a loan made outside the state to a Washington resident. RCW 19.52.034. It cannot be avoided based upon the location of the lender or a contractual choice of law provision. *Whitaker v. Spiegel, Inc.*, 95 Wash. 2d 661, 667-68, 623 P.2d 235 (1981).

3. Treatment of Additional Fees and Charges

Washington law does not specify any limitations on the amount of additional fees and charges that may be assessed in connection with business purpose loans or extensions of credit.

If the usury limit applies, some fees and charges may be treated as interest for purposes of the usury law. *See, e.g., Sparkman & McLean Income Fund v. Wald*, 10 Wash. App. 765, 520 P.2d 173 (1974); *Aetna Finance Company v. Darwin*, 38 Wash. App. 921, 926-27, 691 P.2d 581 (1984). Late charges and default rate interest are not generally treated as interest for such purposes on the theory that they are under the control of the borrower³. *Union Bank v. Kruger*, 1 Wash. App. 622, 626, 463 P.2d 273 (1969). However, that is not necessarily the case where they

³ Presumably, the same theory applies to prepayment charges.

are agreed to as part of a forbearance arrangement or workout entered into after maturity or default. *Metro Hauling, Inc. v. Daffern*, 44 Wash. App. 719, 722, 723 P.2d 32 (1986).

C. Acceleration

Acceleration clauses in promissory notes are enforceable; however, notice to the borrower is required in order to effect the acceleration even if the note provides for automatic acceleration upon default. *A.A.C. Corporation v Reed*, 73 Wash. 2d 612, 615, 440 P.2d 465 (1968). “Acceleration must be made in a clear and unequivocal manner which effectively apprises the maker that the holder has exercised his right to accelerate the payment.” *Glassmaker v. Ricard*, 23 Wash. App. 35, 38, 593 P.2d 179 (1979).

Although notice of acceleration is required, advance notice of intention to accelerate and an opportunity to cure are not. *Jacobson v. McClanahan*, 43 Wash. 2d 751, 754, 264 P.2d 253 (1953).

D. Demand Notes

In general, a promissory note that is payable upon demand is enforceable according to its terms under Washington law. *Allied Sheet Metal Fabricators, Inc. v. Peoples National Bank of Washington*, 10 Wash. App. 530, 533-34, 518 P.2d 734 (1974). A pattern of continued financing under a series of demand notes does not change that. *Id.* Moreover, the general obligation of good faith implicit in every contract “does not extend to obligate a party to accept a material change in the terms of its contract”...Nor does it “inject substantive terms into the parties’ contract.” *Badgett v. Security State Bank*, 116 Wash. 2d 563, 569, 807 P.2d 356 (1991). “Rather, it requires only that the parties perform in good faith the obligations imposed by their agreement.” *Id.* “As a matter of law, there cannot be a breach of the duty of good faith when a party simply stands on its rights to require performance of a contract according to its terms.” *Id.* at 570.

The foregoing rule finds further support in the official comment to Washington’s version of Uniform Commercial Code § 1-208, which generally requires parties to act in good faith when accelerating a debt allowing acceleration at will or when the creditor deems itself insecure. The comment states that § 1-208 “has no application to demand instruments or obligations whose very nature permits call at any time with or without reason.”

For a discussion of the application of the statute of limitation applicable to demand notes, see Section XII.F of this guide.

E. Place of Payment

Tender of payment on a promissory note must be made at the place of payment specified in the note. *U.S. Bank National Association v. Whitney*, 119 Wash. App. 339, 347-48, 81 P.3d 135 (2003). Payment at a separate branch or office of a bank is not effective tender. *Id.* and RCW 62A.4-107.

V. TYPES OF BORROWERS

A. Corporations, Etc.

Washington corporations are subject to the Washington Business Corporation Act (RCW title 23B). That Act contains separate chapters applicable to foreign corporations.

Specialized types of corporations and business associations are provided for in the following statutes:

- Professional service corporations – RCW chapter 18.100
- Employee cooperative associations – RCW chapter 23.78
- Cooperative associations – RCW chapter 23.86
- Massachusetts trusts – RCW chapter 23.90
- Various types of nonprofit corporations – RCW title 24

It is advisable to obtain a “Certificate of Existence/Authorization” from the Washington Secretary of State when making a loan to a corporate borrower. Washington law does not include a concept of corporate “good standing” so it is not technically correct to refer to such a certificate as a “good standing certificate.”

There is no requirement under Washington law that a corporate seal appear on a document executed by a corporation. RCW 60.04.105 provides that: “The absence of a corporate seal on any deed, mortgage, lease, bond or other instrument or contract in writing shall not affect its validity, legality or character in any respect.”

The doctrine of *ultra vires* under which a corporate action can be challenged on the basis that it is beyond the corporate powers of the corporation is severely limited by RCW 23B.03.040 (for for-profit corporations) and RCW 24.03.040 (for nonprofit corporations). *See also Spokane Concrete Products, Inc. v. U. S. Bank of Washington, N.A.*, 126 Wash. 2d 269, 277-78, 892 P.2d 98 (1995). Actions may be challenged on the ground that the corporation did not act in accordance with its governing documents. *Hartstene Point Maintenance Association v. Diehl*, 95 Wash. App. 339, 345, 979 P.2d 854 (1999).

B. Partnerships

Three types of partnerships are recognized in Washington: (1) general partnerships; (2) limited partnerships; and (3) registered limited liability partnerships.

Washington partnerships are subject to the “Partnership” title of the RCW (title 25). RCW chapter 25.05 is Washington’s version of the Revised Uniform Partnership Act. It contains the statutory provisions governing general partnerships and limited liability partnerships. Limited liability partnerships are intended primarily for use by those engaged in

the practice of the licensed professions; however, they are occasionally used for other business purposes.

RCW chapter 25.10 is the primary statute governing limited partnerships, although the very few limited partnerships that were in existence prior to June 6, 1945 are governed by RCW chapter 25.12.

The statutes governing limited partnerships and limited liability partnerships have provisions relating to foreign entities of those types doing business in Washington.

It is advisable to obtain a Certificate of Existence/Authorization from the Washington Secretary of State when making a loan to a borrower that is a limited partnership or limited liability partnership as well as a certified copy of the Certificate of Limited Partnership.

Partners in a general partnership, as well as general partners in a limited partnership, are individually liable for partnership debts; however, with certain limited exceptions, a creditor is generally required to exhaust its recourse against partnership assets before executing on assets of the general partners. This extra step can be avoided by having the general partners waive the requirement of exhaustion of the partnership assets or by having them separately guarantee the debt. *See* RCW 25.05.130(4).

Under a statutory amendment to RCW chapter 25 made in the 2009 legislature, beginning in January 2010 a limited partnership may elect to become a limited liability limited partnership (“LLLP”) by including a statement to that effect in its certificate of limited partnership. Status as an LLLP provides general partners with a shield from liability for obligations of the LLLP.

C. Limited Liability Companies

Limited liability companies (“LLCs”) are governed by RCW chapter 25.15. A Washington LLC may be managed either by its members or by one or more managers. RCW 25.15.150. Single-member LLCs are permitted in Washington.

An LLC is formed by filing a Certificate of Formation with the Washington Secretary of State. RCW 25.15.070. Washington LLCs are required to have a registered office and a registered agent for service of process in Washington. *Id.*

When making a loan to an LLC, it is advisable to obtain a Certificate of Existence/Authorization from the Washington Secretary of State as well as a certified copy of the LLC’s Certificate of Formation.

Individual members and managers of an LLC are not liable for its debts unless they have executed appropriate guaranties or are personally liable in tort. RCW 25.15.125.

There is not an *ultra vires* statute for limited liability companies comparable to the one for corporations discussed in Section V.B above. 1B *Washington Practice* § 70.10 (4th ed. 2008).

D. Proprietorships and Individuals

Loans to proprietorships are treated in the same manner as loans to the individual owners of the business. Trade names are subject to registration with the Washington Secretary of State pursuant to RCW chapter 19.80.

1. Community Property Laws; Registered Domestic Partnerships

a. General

Lenders must take the effects of the Washington community property laws into consideration when contemplating making loans to, or accepting personal guaranties from, married Washington residents. The community property laws are set out in RCW chapter 26.16.

In 2008, the legislature comprehensively revised the community property statutes (and many other statutes) to make them applicable to registered domestic partners as well as to spouses. The changes generally became effective June 12, 2008. Registered domestic partnerships are provided for in RCW chapter 26.60. They may be entered into by two people both of whom are at least age 18 and (a) both of whom are of the same sex or (b) at least one of whom is age 62 or older. RCW 26.60.030. Although, for ease of readability, this guide refers to spouses, the community property concepts described are equally applicable to registered domestic partners after June 12, 2008.

Where individuals live as “committed intimate partners,” Washington courts will in appropriate circumstances divide the partners’ assets in an equitable manner based on the rights they would have had if they had been married to one another. *See, e.g., Olver v. Fowler*, 161 Wash. 2d 655, 168 P.3d 348 (2007).

b. Community Liability for Debts

Washington has an equal management community property system. Under RCW 26.16.030 each spouse has the full authority, acting alone, to enter into debt obligations binding and obligating any and all present and future community property that may exist between husband and wife with the following exceptions:

(i) Neither spouse may devise or bequeath by will more than one-half of the community property.

(ii) Neither spouse may make a gift of community property without the express or implied consent of the other. This provision can be a trap for unwary lenders. Because a guaranty of another person’s debt may be a gift of community property, both spouses should execute, or give their written consent to, guaranties where there is not a clear benefit to the marital community from the guaranteed debt, if the lender intends to have recourse to the spouses’ community property. Moreover, a general power of attorney from one spouse to the other does not authorize a gift of community property unless it expressly contains such authority. *Bryant v. Bryant*, 125 Wash. 2d 113, 119, 882 P.2d 169 (1994). In requiring both spouses to execute such a guaranty, the lender must of course comply with the federal Equal

Credit Opportunity Act (15 U.S.C. § 1691 *et seq.*) and Regulation B promulgated thereunder (12 CFR part 202).

(iii) Neither spouse may sell, convey, or encumber the community real property without the other spouse joining in the execution of the deed or other instrument by which the real estate is sold, conveyed, or encumbered, and such deed or other instrument must be acknowledged by both spouses.

(iv) Neither spouse may purchase or contract to purchase community real property without the other spouse joining in the transaction of purchase or in the execution of the contract to purchase.

(v) Neither spouse may create a security interest, other than a purchase money security interest in, or sell, community household goods, furnishings, or appliances, or a community mobile home unless the other spouse joins in executing the security agreement or bill of sale, if any.

(vi) Neither spouse may acquire, purchase, sell, convey, or encumber the assets, including real estate, or the good will of a business where both spouses participate in its management without the consent of the other; provided, that where only one spouse participates in such management the participating spouse may, *in the ordinary course of such business*, acquire, purchase, sell, convey or encumber the assets, including real estate, or the goodwill of the business without the consent of the nonparticipating spouse. It is unclear whether, or to what extent this rule applies to a business conducted in corporate, partnership or limited liability company form. *See* Washington State Bar Association, *Washington Community Property Deskbook*, § 4.6 (3rd ed. 2003); 19 *Washington Practice* § 12.15 (1997). However, it has been held that the purchase of all the stock of a corporation is subject to the statute and requires the consent of both spouses. *Consumers Insurance Company v. Cimoch*, 69 Wash. App. 313, 320-21, 848 P.2d 763 (1993).

A contract signed by one spouse for the benefit of the marital community creates recourse to all the community assets. If the contract is not for the benefit of the community, there is recourse only to the signing spouse's separate property. In the latter situation, there is no recourse to *any* of the community property. However, there is an extremely strong presumption of community liability and many transactions that might not generally be thought to provide a community benefit are deemed to provide such a benefit for this purpose. *See generally*, Cross, *The Community Property Law in Washington*, 61 *Wash. L. Rev.* 13, 114-125 (1986). The rule is different for tort liability, for which a plaintiff has recourse to one-half the community property for satisfaction of a judgment on a separate tort of one spouse if that spouse's separate property is insufficient to satisfy the judgment. *de Elche v. Jacobsen*, 95 Wash. 2d 237, 622 P.2d 835 (1980); *Keene v. Edie*, 131 Wash. 2d 822, 935 P.2d 588 (1997).

Lenders should be careful about adding words such as "individually" after signatures on guaranties, promissory notes and other instruments. It has been held that doing so can evidence an intention not to bind the signer's marital community and community property even if the transaction actually benefited the community. *Grayson v. Platis*, 95 Wash. App. 824, 837, 978 P.2d 1105 (1999).

Generally, community property is not available to satisfy the separate debts of either spouse. There is, however, an exception to that rule for debts incurred prior to the marriage if the debt is reduced to judgment within three years after the marriage. RCW 26.16.200. This is to prevent people with no significant assets from shielding their income from creditors' claims by marrying and converting their income to community property.

Where one spouse enters into a transaction requiring the joinder of both spouses, the transaction is voidable rather than void and, unless it is actually rescinded or otherwise avoided, it may remain effective. *See, e.g., Sander v. Wells*, 71 Wash. 2d 25, 28-29, 426 P.2d 481 (1967). Where the non-joining spouse was aware of the transaction and encouraged it, he or she may be estopped to rescind or avoid it. *Id.* Other types of conduct by the non-joining spouse may also result in an estoppel, ratification or authorization having the same effect. *Washington Community Property Deskbook, supra*, at § 4.7.

c. Community and Separate Property Distinguished

“Community property” includes any and all property that either spouse acquires during the existence of marriage (other than by inheritance or gift or as appreciation of, or earnings on, separate property). This includes both spouses' earnings. RCW 26.16.030.

“Separate property” includes any property that was owned by either spouse at the time of marriage or that was separately given to or inherited by, such spouse during the marriage, together with appreciation of and earnings on such property. Separate property can become community property through commingling or by the spouses' execution of a community property agreement. RCW 26.16.010 and .020. Also, income produced by substantial labor in managing separate assets is community property. *Marriage of Bernard*, 165 Wash. 2d 895, 904, 204 P.3d 907 (2009).

d. Conflict of Laws Issues

Complicated conflict of laws questions relating to marital property issues can arise in multi-state credit transactions. Although Washington law is not a model of clarity on these issues, the more recent cases hold that Washington courts will generally apply the law of the state of the spouses' residence when determining the property against which a creditor has recourse to satisfy a loan or other contract debt regardless of the law otherwise governing the contract, especially where only one of the spouses is a signatory to the contract. *G.W. Equipment Leasing, Inc. v. Mt. McKinley Fence Co., Inc.*, 97 Wash. App. 191, 197-98, 982 P.2d 114 (1999); *Colorado National Bank v. Merlino*, 35 Wash. App. 610, 620-21, 668 P.2d 1304, rev. den. 100 Wash. 2d 1032 (1983); *Potlatch No. 1 Federal Credit Union v. Kennedy*, 76 Wash. 2d 806, 813, 459 P.2d 32 (1969). *But see Pacific Gamble Robinson Co. v. Lapp*, 95 Wash. 2d 341, 622 P.2d 850 (1980) (Colorado law applied to marital property issues in action to recover on contract entered into while Washington spouses previously lived in Colorado), and *Pacific States Cut Stone Company v. Goble*, 70 Wash. 2d 907, 425 P.2d 631 (1967) (Oregon law applied to marital property issues in action by Oregon creditor to recover on contract entered into in Oregon by Washington husband).

Conflict of laws issues also arise in determining what marital property laws apply where spouses have moved from one state to another during their marriage or where they own property located in multiple states. Generally, the character of personal property, as separate property, community property or otherwise, is determined by the law of the state of the spouses' domicile at the time of acquisition. *Pacific States Cut Stone Company v. Goble*, 70 Wash. 2d 907, 910, 425 P.2d 631 (1967). The character of real property, however, is determined by the law of the state where the property is located. *Meng v. Security State Bank of Woodland*, 16 Wash. 2d 215, 222, 133 P.2d 293 (1943). Of course, the character of property may be affected by a prenuptial agreement, community property agreement or similar status of property agreement entered into by the spouses.

While the natural reaction of many lenders to the complexities of the community property laws is to require that both spouses become borrowers or guarantors, lenders' ability to impose such a requirement is seriously limited by the requirements of the federal Equal Credit Opportunity Act (15 U.S.C. § 1691 *et seq.*) and Federal Reserve Board Regulation B thereunder (12 C.F.R. 202). A discussion of these federal requirements is beyond the scope of this guide.

2. Property Held in Joint Tenancy With Right of Survivorship

Joint tenancy with right of survivorship is addressed in RCW chapter 64.28. Each joint tenant has a unilateral right to terminate the joint tenancy during his or her lifetime. RCW 64.28.010. Upon the death of one joint tenant, property owned in joint tenancy with right of survivorship is owned by the surviving joint owner and is not an asset of the probate estate available for the payment of creditors' claims in the estate. *In re Baxter's Estate*, 68 Wash. 2d 294, 412 P.2d 777 (1966).

One joint tenant with right of survivorship may grant a lien on the property held in joint tenancy without the joinder of the other joint tenant; however, if the joint tenant who grants the lien dies before the other joint tenant, the surviving joint tenant takes the property free of the lien. *Kalk v. Security Pacific Bank*, 126 Wash. 2d 346, 350-52, 894 P.2d 559 (1995). On the other hand, it appears that foreclosure of the lien during the lifetime of the granting joint tenant would be effective to deprive the other joint tenant of his or her interest in the property. *Id.*

3. Property Exempt from Claims of General Creditors

Certain assets, up to specified values, are exempt from seizure to satisfy the claims of general unsecured creditors of individuals. These include, by way of example: (a) generally, the first \$125,000 in equity in the homestead (increased from \$40,000 by the 2007 legislature); (b) furniture and personal household items; (c) tools of the trade; (d) the proceeds and cash surrender value of life insurance and annuity contracts; and (e) pension rights and assets held in tax-deferred retirement plans and accounts. The homestead exemption is provided for in RCW chapter 6.13 and the personal property exemptions in RCW chapter 6.15. The homestead exemption is discussed in greater detail in Section VI.R of this guide.

4. Age of Majority

In general, the age of majority at which a person has the capacity to enter into a binding contract is 18. RCW 26.28.010 and 26.28.015(4). There are special exceptions for minors

married to persons over the age of majority and for certain educational loans entered into by minors over the age of 16.

A person who enters into a contract while under the age of majority generally can disaffirm the contract within a reasonable time after reaching the age of majority if he or she restores to the other party all money and property received under the contract that remains within his or her control at any time after reaching the age of majority. RCW 26.28.030. There are exceptions to the right to disaffirm where the minor misrepresented his or her age or engaged in business as an adult, or where the other party “had good reason to believe the minor capable of contracting.” RCW 26.28.040.

E. Trusts and Estates

Washington’s basic trust statutes are RCW chapters 11.96A through 11.118.

Generally, when a trustee of a trust enters into a loan or other contract, the trustee “may be held personally liable on the contract, if personal liability is not excluded.” RCW 11.98.110(2). Personal liability is deemed to be excluded by the addition of the words “trustee” or “as trustee” after the signature or by the transaction of business as trustee under an assumed name in compliance with RCW chapter 19.80 (similar rules apply to estates and personal representatives of decedents). *Id.* Therefore, if the lender wants to ensure that a trustee, settlor of a trust or personal representative of an estate is personally liable for the loan, in addition to obtaining the liability of the trust or estate, it is advisable to have that person execute an appropriate guaranty in his or her personal capacity. If the trustee, settlor or personal representative simply signs the promissory note in his or her individual capacity, he or she may later argue that the signature was as an accommodation party or surety and the lender could be subjected to unwaived suretyship defenses. *See generally Grayson v. Platis*, 95 Wash. App. 824, 837, 978 P.2d 1105 (1999).

Washington has an unusual statute that provides that the trustee of a trust may not enter into a “significant nonroutine transaction” in the absence of a “compelling circumstance” (both terms are defined in the statute) without giving certain notices to the trustors of the trust, if living, and to certain beneficiaries. RCW 11.100.140. One of the types of nonroutine transactions described in the statute, which could be argued to apply to certain loan transactions is:

Any sale, option, lease, or other agreement, binding for a period of ten years or more, dealing with any interest in real estate other than real estate purchased by the trustee or a vendor’s interest in a real estate contract, the value of which constitutes twenty-five percent or more of the net fair market value of trust principal at the time of the transaction.

RCW 11.100.140(2)(a). When a lender is making a loan secured by trust property that may be subject to the statute, it is advisable to obtain a certificate from the trustee or trustees stating that the requirements of the statute have been met. The lender is entitled to rely on such a written statement unless it has actual knowledge that it is inaccurate. RCW 11.100.140(7).

Unlike California, Oregon and a number of other states, Washington does not have a statute generally allowing parties dealing with trustees to rely on a certification of the trustees as to the identity of the trustees, their powers, nonrevocation of the trust, etc.

Transfers to a trust established for the benefit of the person making the transfer are void as against that person's existing and subsequent creditors. RCW 19.36.020. Curiously, the Washington Supreme Court has held that, where settlors established a trust for the benefit of their minor children but retained the right to revoke the trust or remove assets from it and to revest the assets in themselves, the trust assets could not be reached by the settlors' creditors prior to such a revocation or removal. *Van Stewart v. Townsend*, 176 Wash. 311, 28 P.2d 999 (1934). The court's decision was based on the theory that the trust in question did not satisfy RCW 19.36.020's requirement that the transfer be made in trust "for the use of the person making the same." *Id.* at 316. The court did not consider that result to be changed by the existence of the power of revocation or by the fact that no distributions were to be made to the settlors' children until after the death of one of the settlors. For a criticism and questioning of the continued vitality of the *Van Stewart* case, see Andrews, Creditors' Rights Against Nonprobate Assets in Washington: Time for Reform, 65 *Wash. L. Rev.* 73, 115-116 (1990). The *Van Stewart* rule may not prevent the trust property from becoming a part of the settlor's bankruptcy estate under 11 U.S.C. § 541. See IV Scott, *The Law of Trusts* § 330.12 (4th ed. 1989).

Generally, claims against a decedent's estate must be filed by the later of (i) four months after the personal representative publishes the notice required by RCW 11.40.020 or (ii) thirty days after the personal representative mails notice to the creditor. RCW 11.40.051. There is a dearth of law in Washington on the treatment of contingent claims (for example, the claim of a lender under a guaranty where the guaranteed loan is not in default) in probate proceedings.

Pursuant to RCW 11.56.010, a personal representative generally may not sell, lease or mortgage real or personal property without an order of the court supervising the probate. However, if the personal representative has been granted nonintervention powers by the court, he or she may take these actions, among many others, without court order and without notice, approval or confirmation. RCW 11.68.090.

VI. REAL ESTATE LENDING

A. Property Rights

Real property rights in Washington are generally governed by RCW title 58 (Boundaries and Plats), title 59 (Landlord and Tenant), title 61 (Mortgages, Deeds of Trust and Real Estate Contracts), title 64 (Real Property and Conveyances) and title 65 (Recording, Registration and Legal Publication).

B. Leases

A lease for a period longer than one year (including any extension options) must be in writing, signed by the landlord, acknowledged and accepted by the tenant. RCW 64.04.010-.020. A lease for one year or less must be in writing and signed by the landlord, but need not be acknowledged. RCW 59.04.010 and 59.18.210. Generally, a lease with a term of two years or

more, or a memorandum of that lease, must be recorded in the real property records of the county where the property is located or it will be void as against holders of subsequently recorded interests in the property. RCW 65.08.060-.070. However, such leases are commonly not recorded and, if the lessee has possession of the premises, that possession should be effective to impart constructive notice of the lessee's rights (at least its right to occupy the property as a tenant and perhaps other rights such as options to purchase the property). *See II Washington Real Property Deskbook*, § 27.11(1)(d) (1996); *III Washington Real Property Deskbook*, § 41.6(9) (1996); *Scott v. Woolard*, 12 Wash. App. 109, 529 P.2d 30 (1974).

C. Condominiums

Washington's condominium law is contained in RCW chapters 64.34 (for condominiums created after July 1, 1990) and 64.32 (for those created prior to that date). The two chapters have different provisions regarding the relative priorities of assessment liens for condominium dues with respect to the lien of a deed of trust or mortgage. *Compare* RCW 64.34.364 *with* RCW 64.32.200.

RCW 64.34.445 imposes certain implied warranties of quality in sales of condominium units by declarants and "dealers." A lender foreclosing on a condominium project needs to be concerned about the ramifications of becoming a dealer when it resells the units and of becoming a successor declarant. *See* RCW 64.34.020(13) and (14) and 64.34.316. RCW 64.34.316(5)(d) provides a mechanism for a foreclosing lender to record a document at the time it acquires title to a condominium project declaring its intention to hold special declarant rights on which it forecloses "solely for transfer to another person" (*i.e.*, a developer to which it sells its entire interest in the project). Recording such a declaration limits the lender's potential liability as declarant but perhaps not its liability as a dealer.

D. Types of Real Property Security Instruments

Although mortgages and real estate contracts are permitted, the deed of trust is the preferred form of real property security instrument in Washington. Mortgages are commonly used for agricultural property, but otherwise, deeds of trust are almost universally used. Washington has been a lien theory state since the territorial legislature enacted the original version of RCW 7.28.230 in 1869. *Kezner v. Landover Corporation*, 87 Wash. App. 458, 463, 942 P.2d 1003 (1997). As such, a mortgagee is not entitled to possession of the property prior to a foreclosure sale. *Id.*

1. Deeds of Trust

Deeds of trust are governed by RCW chapter 61.24. The borrower is referred to in the deed of trust statute as the "grantor" and the lender is referred to as the "beneficiary." RCW 61.24.005. The deed of trust statute is strictly applied and interpreted in favor of the grantor. *Amaresco Independence Funding, Inc. v. SPS Properties, LLC*, 129 Wash. App. 532, 536-37, 119 P.3d 884 (2005). Except as otherwise provided in RCW chapter 61.24, all Washington laws relating to mortgages also apply to deeds of trust. RCW 61.24.020.

a. Trustee Under Deed of Trust

The title insurance company insuring the transaction is generally named as the trustee under the deed of trust, although certain other classes of persons and entities are also permitted to act as trustee by RCW 61.24.010. In order to foreclose nonjudicially, the trustee must have a street address in Washington. RCW 61.24.030(6). The beneficiary of the deed of trust may not also be the trustee, except in cases where an agency of the United States government is the beneficiary. RCW 61.24.020. The trustee need not formally accept appointment as trustee and, unless the deed of trust is foreclosed, the trustee is not generally paid a fee except a small fee for reconveying the deed of trust when it has been satisfied. The beneficiary may replace the trustee without the consent or signature of the trustee. RCW 61.24.010(2). If the deed of trust is foreclosed, the beneficiary typically replaces the trustee with the lawyer handling the foreclosure or with a foreclosure service company.

In *Cox v. Helenius*, 103 Wash. 2d 383, 693 P.2d 683 (1985), the court held that the trustee is a fiduciary for both parties to the deed of trust but that its responsibilities are “less extensive than those of trustees in other fiduciary settings.” *Id.* at 389. Where a lawyer for the beneficiary acts as trustee and an “actual” conflict arises between the grantor and the beneficiary, the lawyer should resign from one of the two roles. *Id.* at 390. An agreement by which the beneficiary agrees to indemnify the trustee against claims arising out of the trustee’s actions is not *per se* a breach of the trustee’s fiduciary duty, but it does require “heightened judicial scrutiny of any claims of breach of fiduciary duty.” *Meyers Way Development Limited Partnership v. University Savings Bank*, 80 Wash. App. 655, 666, 910 P.2d 1308 (1996). The fiduciary duty standard imposed by *Cox v. Helenius* has been changed to a good faith standard by a 2009 amendment to RCW 61.24.010. Subsections (3) and (4) of that statute now provide:

(3) The trustee or successor trustee shall have no fiduciary duty or fiduciary obligation to the grantor or other persons having an interest in the property subject to the deed of trust.

(4) The trustee or successor trustee has a duty of good faith to borrower, beneficiary, and grantor.

It remains to be seen the extent to which that change will affect the substantive obligations of the trustee as set out in *Cox v. Helenius*.

b. Nonagricultural Use

Deeds of trust should not be used on property that is principally used for agricultural purposes (*i.e.*, “if it is used in an operation that produces crops, livestock, or aquatic goods”). RCW 61.24.030(2). However, if a deed of trust is used on an agricultural property, it still creates a valid lien and can be foreclosed judicially as a mortgage. RCW 61.24.020 and .030(2). To be foreclosed nonjudicially, a Washington deed of trust must contain a statement that the “property is not used principally for agricultural purposes” and that statement must be true either on the date the deed of trust is granted, on the date it is amended to include that statement, or on the date of the foreclosure sale. RCW 61.24.030(2). In the absence of such a provision, the deed of trust cannot be foreclosed nonjudicially but, instead must be foreclosed as a mortgage in a judicial foreclosure action. RCW 61.24.

No definitive law exists on whether, or under what circumstances, timberland is considered to be agricultural in nature. In a different context, the court in *Rainier National Bank v. Security State Bank*, 59 Wash. App. 161, 796 P.2d 443 (1990) held that growing Christmas trees are “farm products” under Article 9 of the Uniform Commercial Code notwithstanding their relatively long growing cycle and the fact that they are not harvested annually. The court in that case rejected contentions that the trees were “fixtures” or “inventory” under Article 9 and did not explicitly consider the possibility that they might be “timber.” That “standing timber” is excluded from the definition of “farm products” under the current version of Article 9, which took effect in 2001 (see RCW 62A.9A-102(a)(34)); however, “standing timber” is not defined. The version of Article 9 in effect when the *Rainier National Bank* case was decided did not exclude standing timber from the definition of farm products. Lenders on ordinary timberland in Washington (including replanted timberland) generally use deeds of trust containing a standard non-agricultural use clause. For additional detail on this issue, see Kaplan *et al.*, *Washington Secured Transactions Under Revised Article 9 of the UCC*, chapter 7.8 (2005 ed.). See, also, RCW 7.48.35 (appears to treat “agricultural activities on farmland” and “forest practices” as distinct and separate categories for purposes of nuisance actions); RCW 36.70.A.030(2) (portion of Growth Management Act that defines “agricultural land” to include land primarily devoted to the commercial production of Christmas trees that are not subject to certain excise taxes on forest land); RCW 84.33.100 (definitions relating to timber and forest lands for property tax purposes); *State v. Christensen*, 18 Wash.2d 7, 22, 137 P.2d 512 (1943) (quoting dictionary definition of “agriculture” that includes “forestry”).

c. Master Form Deeds of Trust

Washington has a statute permitting a lender to record a master form deed of trust which sets forth standard terms and to incorporate those standard terms into individual loan transactions by having the borrower execute a short form deed of trust incorporating the terms of the master form by reference. RCW 65.08.160. This procedure is very little used.

2. Mortgages

Mortgages are provided for in RCW chapter 61.12. They may only be foreclosed through the judicial foreclosure process, which generally entails a one-year redemption period. Mortgages are used almost exclusively for financing agricultural property for which a deed of trust is not appropriate.

3. Real Estate Contracts

Real estate contracts, which are provided for in RCW chapter 61.30, are not a recommended form of real property security in Washington. They are rarely used except in seller financing of agricultural property, which cannot otherwise be foreclosed upon nonjudicially. A vendor’s interest in a real estate contract has components of both real and personal property and a security interest in it must be perfected both by filing a financing statement in accordance with Article 9 of the Uniform Commercial Code and by recording an appropriate form of real property security instrument. See *IV Washington Real Property Deskbook* § 48.9(1)(a); *Freeborn v. Seattle Trust & Savings Bank*, 94 Wash. 2d 336, 343-44, 617 P.2d 424 (1980). The status of the vendee’s interest as real or personal property is less clear.

See IV *Washington Real Property Deskbook* § 48.4(1) (1996). A prudent creditor taking a security interest in the vendee's interest will also both file a financing statement and record an appropriate real estate security instrument, preferably a deed of trust.

Because real estate contracts are rarely encountered in commercial financing transactions, they are not discussed at length in this guide. More detailed treatment can be found in 18 *Washington Practice* § 21 (2d ed. 2004) and III *Washington Real Property Deskbook* chapter 45 (1996).

E. Formalities of Deeds of Trust and Mortgages

A deed of trust or mortgage must be in writing, executed by the party to be bound and acknowledged, although it may be effective between the parties even if it is not acknowledged. RCW 64.04.020 and 65.08.070. Certain formal requisites for a deed of trust are set out in RCW 61.24.010-.030. A sample form of mortgage is provided in RCW 61.12.020. A mortgage or deed of trust is valid even if it does not state the amount of the debt secured. *Spedden v. Sykes*, 51 Wash. 267, 273, 98 Pac. 752 (1908).

F. Assignments of Leases and Rents

In 1969, the legislature amended RCW 7.28.230 to make assignments of rents effective prior to completion of a foreclosure. Before those amendments, an assignment of rents in a mortgage was ineffective. See, e.g., *State of Washington ex rel. Gardner J. Gwinn, Inc. v. Superior Court*, 170 Wash. 463, 16 P.2d 831 (1932). For a detailed treatment of the assignment of rents statute and its history, see 18 *Washington Practice* § 18.5-§ 18.7 (2d ed. 2004).

After the 1989 amendment of RCW 7.28.230, it is clear that an assignment of rents is "perfected" upon recording and no further act (such as appointment of a receiver) is necessary in order to protect the assignment against avoidance in a bankruptcy of the borrower due to lack of perfection. RCW 7.28.230(3); *In re Park at Dash Point, L.P.*, 985 F.2d 1008 (9th Cir. 1993).

The deed of trust statute contains limitations on a lender's ability to collect the rents from small residential rental properties. It provides:

The beneficiary shall not enforce or attempt to enforce an assignment of rents by demanding or collecting rent from a tenant occupying property consisting solely of a single-family residence, or a condominium, cooperative, or other dwelling unit in a multiplex or other building containing fewer than five residential units, without first giving the tenant either a court order authorizing payment of rent to the beneficiary or a written consent by the tenant's landlord to the payment. It is a defense to an eviction based on nonpayment of rent that the tenant paid the rent due to the beneficiary pursuant to a court order or a landlord's written consent.

RCW 61.24.140. This statute does not appear to affect the creditor's rights under a mortgage or a real estate contract.

G. Property Insurance

RCW 48.27.010 and .020 prohibit a lender from requiring casualty insurance in an amount in excess of the replacement cost of the property regardless of the amount of the loan.

WAC 284-21-010 specifies the forms of lender's loss payable and mortgagee clauses that may be used in Washington.

RCW 48.30.015 and the insurance commissioner's regulations referred to in that statute impose several strict time limits within which insurers must acknowledge receipt of, investigate and affirm or deny coverage under insurance policies. Failure to comply with those requirements can subject the insurer to an award of three times the actual damages. RCW 48.30.015(2).

H. Recordation and Acknowledgments

1. Recordation

To be effective against subsequent purchasers or mortgagees in good faith and for a valuable consideration, a mortgage, deed of trust or real estate contract must be recorded in the county where the property is located. RCW 65.08.070. Under the recording statute, the holder of a recorded security instrument takes subject to any prior encumbrance of which that holder has either actual or constructive notice. *Kim v. Lee*, 145 Wash. 2d 79, 86, 43 P.3d 1222 (2001). Therefore, the holder's recorded security instrument is junior to any prior unrecorded encumbrance if the holder has actual knowledge of it and is junior to any prior recorded encumbrance regardless of whether the holder has actual knowledge of it. Because Washington's "race notice" recording statute gives priority to an earlier unrecorded lien if the holder of the later lien has notice of it, parties should not rely on recording order alone to set the priority of instruments recorded substantially concurrently, but should record an instrument clearly subordinating the intended junior instrument to the intended senior one. For an example of litigation arising out of a failure to take that approach, see *Richards v. Lawing*, 175 Wash. 544, 550, 27 P.2d 730 (1933). See also 18 *Washington Practice* § 18.21 (2009).

RCW 65.08.030 provides that an instrument that has been recorded imparts notice of its contents despite any defects or irregularities in its execution or acknowledgment. See *In re Smith*, 93 Wash. App. 282, 288-289, 968 P.2d 904 (1998).

Washington has very strict statutory requirements for the formatting of documents to be recorded. RCW 65.04.045-.047. The key requirements are set out in Exhibit A to this guide. Documents that do not comply with these requirements can be refused for recording by the recording office.

2. Torrens System

Washington has a Torrens land registration system, which is provided for in RCW chapter 65.12. An extremely small amount of land in the state is registered under the Torrens system. Mortgages and deeds of trust on Torrens-registered lands must be registered in the Torrens system and foreclosed as provided in the Torrens statute. It is not clear that a deed of

trust on such land can be foreclosed using the normal nonjudicial deed of trust foreclosure procedures of RCW chapter 61.24. The Torrens statute contains a provision for withdrawing registered lands from the Torrens system. RCW 65.12.230 *et seq.*

3. Notary Acknowledgments

All recorded documents must be acknowledged by a notary public or other appropriate official. RCW chapter 64.08 sets out the Washington law regarding acknowledgment of recorded documents. Acknowledgments in Washington are almost always taken before notaries public, although certain other officials are empowered to take them. *See* RCW 42.44.130-.150 and RCW 64.08.010 and .090. An acknowledgment form that substantially complies with the applicable form of acknowledgment set out in RCW 64.08.060 (individual form) and .070 (corporate form) is sufficient. For entities other than corporations, the certificate form set out in RCW 64.08.070 is generally used with appropriate modifications to reflect the type and structure of the relevant entity.

Acknowledgments taken outside the state are acceptable, but only if they meet the minimum requirements of RCW 42.44.090(1) and (2). The provisions for acknowledgments taken outside the state are set forth in RCW 42.44.090(2) and RCW 64.08.020 and .040. It is generally preferable to use the Washington forms of acknowledgment for documents to be recorded in Washington.

4. Recording Fees

Washington has relatively nominal recording fees. Although fees vary somewhat from county to county, as of July 26, 2009, a typical recording fee for a deed of trust is sixty-three dollars for the first page and one dollar for each additional page. Washington has no recording tax, mortgage tax, stamp tax or similar tax on recording of deeds of trust or mortgages.

I. Priority Issues

1. Future Advances

Washington has a very broad and lender-favorable priority statute for future advances. RCW 60.04.226. It provides:

Except as otherwise provided in RCW 60.04.061 [relating to construction liens for work or material deliveries begun prior to recording of the mortgage or deed of trust] or 60.04.221 [relating to the “stop notice” law described below], any mortgage or deed of trust shall be prior to all liens, mortgages, deeds of trust, and other encumbrances which have not been recorded prior to the recording of the mortgage or deed of trust to the extent of all sums secured by the mortgage or deed of trust regardless of when the same are disbursed or whether the disbursements are obligatory.

On its face, this statute appears clearly to allow a mortgage or deed of trust to remain prior to subsequent mortgages, deeds of trust and other liens even as to non-obligatory future advances made after the recording of the subsequent lien. However, a decision of the Ninth

Circuit Court of Appeals raises the possibility that the priority scheme set out in the statute may apply only where the junior lien is a mechanic's or material supplier's lien under RCW chapter 60.04. *In re Stanton*, 303 F.3d 939 (9th Cir. 2002). The case raised, but declined to decide, the issue. One leading Washington authority has described this aspect of the *Stanton* decision as "incomprehensible" given the clear language of the statute. *27 Washington Practice* § 3.47 fn.7 (2008 pocket part).

Prior to the enactment of the statute's predecessor in 1973, obligatory advances that the lender was required to make under the loan documents had priority over subsequently recorded liens, but optional advances that the lender was not required to make were junior to subsequent liens of which the lender had notice. *John M. Keltch, Inc. v. Don Hoyt, Inc.*, 4 Wash. App. 580, 583-84, 483 P.2d 135 (1971).

If the distinction between obligatory advances and optional advances remains relevant for some purposes, lenders should be aware that there is authority in Washington for the proposition that fairly typical conditions to disbursement contained in loan documents may be held to have given the lender such broad discretion that they thereby "rendered the advances optional rather than obligatory for the purpose of determining the priority of liens." *National Bank of Washington v. Equity Investors*, 81 Wash. 2d 886, 899, 506 P.2d 20 (1973). The Washington Supreme Court has also held that a senior lender's advance of funds to complete construction on the mortgaged property pursuant to an optional remedies provision of the mortgage where the lender had knowledge of a junior mortgage on the property resulted in subordination of the senior mortgage to the junior mortgage to the extent of the advances to complete construction. *Elmendorf-Anthony Company v. Dunn*, 10 Wash. 2d 29, 116 P.2d 253 (1941). The court so ruled despite evidence that the completion of construction increased the value of the property by more than the amount of the advances. *Id.* at 10 Wash. 2d 33. The court did, however, state that payment of taxes by the senior lender pursuant to a typical mortgage provision allowing it to pay taxes would not result in subordination of its lien. *Id.* at 10 Wash. 2d 43.

The history of the enactment of the predecessor statute to RCW 60.04.226 and of the future advance issue in Washington up to its enactment is set out in Note, Mechanics' Liens: *The "Stop Notice" Comes to Washington*, 49 Wash. L. Rev. 685 (1974).

2. Modification of Deeds of Trust and Mortgages

A lender that enters into a modification of its deed of trust or mortgage runs the risk of having its lien subordinated to the lien of an otherwise junior encumbrance on the property if and to the extent that the modification is materially prejudicial to the interests of the junior lienholder. *Kim v. Lee*, 145 Wash. 2d 79, 89-90, 43 P.3d 1222 (2001).

3. Purchase Money Priority

Washington's law on the priority of purchase money mortgages and deeds of trust derives from a handful of early cases. Generally, a purchase money mortgage or deed of trust will take priority as a lien on the purchased property over an earlier judgment lien against the purchaser or over a simultaneous non-purchase money mortgage or deed of trust. *Bisbee v. Carey*, 17 Wash. 224, 49 Pac. 220 (1897); *Skeel v. Christenson*, 17 Wash. 649, 50 Pac. 466 (1897); 1 *Washington*

Practice § 12.5 (4th ed. 1997). However, if the non-purchase money instrument is recorded first and the recorded documents do not sufficiently state the intended order of priority, the non-purchase money instrument can take priority. *Bank of Gresham v. Johnson*, 143 Wash. 2d, 254 Pac. 464 (1927).

4. Priority of Options to Purchase

An option to purchase real estate, whether it is in a lease or in a separate agreement, has priority over subsequently-recorded interests in the property. *Crowley v. Byrne*, 71 Wash. 444, 129 Pac. 113 (1912). *See also, Spokane School District No. 81 v. Parzybok*, 96 Wash. 2d 95, 96-97, 633 P.2d 1324 (1981). Therefore, a lender taking a deed of trust or other security instrument junior to an option to purchase the property runs the risk of having its lien eliminated by exercise of the option, although it should be able to claim a lien on the proceeds of the sale under the option.

5. Equitable Subrogation

Washington has adopted the doctrine of equitable subrogation, by which a refinancing lender, whose loan proceeds are used to pay off an earlier deed of trust, mortgage or other lien, can take the priority of the paid off lien ahead of existing junior liens. *Kim v. Lee*, 145 Wash. 2d 79, 89, 43 P.3d 1222 (2001). The refinancing lender can be entitled to equitable subrogation regardless of its actual or constructive knowledge of the junior lien. *Bank of America, N.A. v. Prestance Corp.*, 160 Wash. 2d 560, 160 P.3d 17 (2007). Oddly, the Washington Supreme Court has stated that this result may not apply to protect the refinancing lender's title insurance company. *Kim v. Lee*, 145 Wash. 2d 79, 91-92, 43 P.3d 1222 (2001).

6. Subordination Agreements

For a discussion of subordination agreements, see Section XII.N of this guide.

J. Title Insurance

Institutional lenders universally obtain title insurance on deeds of trust and mortgages on commercial property in Washington. The ALTA policy forms and endorsements are available. Title companies will generally issue the 2006, the 1992 or the 1970 policy form, but prefer to issue the 2006 or the 1992 form. Many endorsement forms follow the numbering scheme used for California Land Title Association endorsement forms. A wide variety of endorsements is available in the state. There are no significant regulatory restrictions on title insurers' ability to issue endorsements and title companies are often willing to make manuscripted changes in endorsement forms or to create special endorsements to address an unusual situation.

Construction lenders frequently obtain an "intervening liens" endorsement (sometimes referred to as a "Seattle" endorsement), which protects the lender in certain situations in which it stops funding a construction loan due to the borrower's failure to meet conditions to disbursement or where the loan proceeds are insufficient to complete the project. The intervening liens endorsement is not commonly recognized outside the State of Washington.

The survey exception is typically deleted from lenders' policies without a current survey being required.

It is advisable for the lender to obtain a subdivision endorsement (often identified as CLTA form 116.7) insuring that the encumbered property constitutes a legal parcel that can be conveyed legally under the Washington subdivision statute, RCW chapter 58.17. If it is not a legal parcel, the deed of trust or mortgage cannot legally be foreclosed prior to a proper subdivision making the encumbered property a legal parcel because, unlike some other states' subdivision laws, the Washington statute does not include an exception for foreclosures. *See* RCW 58.17.040.

RCW 48.30.015's time limits for responding to claims and its triple damages penalty for violations apply to title insurers as well as other types of insurers. *See* WAC 284-30-310 and discussion in Section VI.G. of this guide.

K. Prepayment

Washington follows the "perfect tender in time" rule, which holds that prepayment of a promissory note for a stated term is not permitted unless the note so provides or the holder otherwise consents. *McCausland v. Bankers Life Insurance Company of Nebraska*, 110 Wash. 2d 716, 723-24, 757 P.2d 941 (1988); *George v. Fowler*, 96 Wash. App. 187, 978 P.2d 565 (1999). For a prepayment fee or premium provision to be enforceable upon prepayment resulting from a default and acceleration of the debt, it must expressly provide that it is applicable in that situation. *Rodgers v. Rainier National Bank*, 111 Wash. 2d 232, 237-38, 757 P.2d 976 (1988).

L. Due on Sale or Encumbrance Clauses; Transfer of the Mortgaged Property; Assumption Agreements

To the extent the federal Garn-St. Germain Depository Institutions Act of 1982 (the "Garn Act"), 12 U.S.C. Section 1701j-3 *et seq.* does not preempt the field and mandate enforceability of "due on sale" or "due on encumbrance" clauses, the enforcement of such clauses will be limited by certain Washington cases holding that the lender must demonstrate that enforcement is necessary to protect the lender against impairment of its collateral or against an increased risk of default. *See, e.g., Bellingham First Federal Savings & Loan Association v. Garrison*, 87 Wash. 2d. 437, 553 P.2d 1090 (1976). Prior to the Garn Act, the Washington Supreme Court held that a provision in a mortgage allowing the lender to increase the interest rate as a result of the transfer of the mortgaged property by the borrower is enforceable absent duress, misrepresentation, overreaching or other inequitable circumstances. *Miller v. Pacific First Federal Savings and Loan Association*, 86 Wash.2d 401, 405-06, 545 P.2d 546 (1976). An absolute prohibition on sale of the property combined with an absolute prohibition on prepayment may be an unenforceable restraint on alienation unless the lender can show that enforcement is necessary in order to protect its security. *Terry v. Born*, 24 Wash. App. 652, 604 P.2d 504 (1979).

Where the owner of an encumbered property transfers the property to a transferee who agrees with the transferor to assume liability for a loan secured by the property, the lender is

entitled to enforce that agreement and can obtain a deficiency judgment against the transferee even if the lender is not a party to the agreement and even if there are intervening grantees who have not assumed the loan. *Citizens Savings & Loan Society v. Chapman*, 173 Wash. 539, 545-46, 24 P.2d 63 (1933). The assumption agreement need not necessarily be an agreement signed by the assuming transferee. *See, e.g., Federal National Mortgage Association v. Carrington*, 60 Wash. 2d 410, 416, 374 P.2d 153 (1962) (assumption provided for in deed signed only by seller); *Hargis v. Hargis*, 160 Wash. 594, 598-99, 295 Pac. 742 (1931) (oral agreement to assume enforced). *See* Section IX.C of this guide for a discussion of the suretyship issues that may arise in such transfer situations.

M. Cancellation of Deeds of Trust and Mortgages

When the debt secured by a deed of trust is paid, the beneficiary of the deed of trust executes a request for full reconveyance of the deed of trust and delivers it to the trustee. The trustee then executes and records a full reconveyance. To cancel a mortgage after the debt is paid, the mortgagee must record a satisfaction of mortgage. RCW 61.16.020 provides the mechanics for the mortgagee to record an acknowledgment of satisfaction of a mortgage and RCW 61.16.030 provides the mortgagor with a right to damages and attorneys' fees if the mortgagee fails to acknowledge satisfaction within sixty days after request by the mortgagor. If a deed of trust or mortgage is mistakenly released of record, a court should reinstate it if there is no prejudice to a third party. *U.S. Bank National Association v. Oliverio*, 109 Wash. App. 68, 33 P.3d 1104 (2001).

N. Assignments of Deeds of Trust and Mortgages

Assignments of deeds of trust, mortgages and real estate contracts must be recorded in order to be effective against third parties. RCW 65.08.060(3) and 65.08.070. Recording an assignment of a mortgage is not, by itself, considered notice of the assignment to the mortgagor or its heirs or representatives for purposes of invalidating payments made to the prior mortgagee. RCW 65.08.120. RCW chapter 61.16 provides for assignment of mortgages by means of a signed and acknowledged written instrument. An assignment of a mortgage or deed of trust and the debt it secures is effective between the parties even without recording or endorsement of the related promissory note. *In re United Home Loans, Inc.*, 71 B.R. 885, 889-91 (W.D. Wash. 1987). However, for maximum protection against claims of third parties, the original note should be appropriately indorsed and delivered to the assignee and the assignment should be recorded.

O. Default and Foreclosure Remedies

1. In General

a. *Types of Foreclosure Proceedings*

Washington law permits both judicial and non-judicial foreclosure of deeds of trust. Only judicial foreclosure is permitted for mortgages. A special statutory procedure is available for forfeiture of real estate contracts. The beneficiary of a deed of trust, which has a choice of the judicial or nonjudicial foreclosure procedure, will almost always decide to foreclose nonjudicially unless it wants to obtain a deficiency judgment against the borrower or against a

guarantor in a situation not permitted in connection with a nonjudicial foreclosure. Where a deed of trust is foreclosed nonjudicially, there is no right of redemption after the foreclosure sale. RCW 61.24.050. If, however, it is foreclosed judicially, the same redemption rights apply as would apply in a mortgage foreclosure. See Section VI.O.3 below.

Either a nonjudicial foreclosure or a judicial foreclosure is likely to take a minimum of approximately five months to complete absent any resistance from the borrower or other parties. If there is resistance, the process can take much longer. In the case of judicial foreclosure, an eight or twelve-month redemption period almost always follows the foreclosure sale.

b. Receivers

It is common for a receiver to be appointed to take possession of commercial real estate securing a defaulted loan. See Section X below for a discussion of Washington's receivership law.

c. Effect of Foreclosure on Junior Leases

Washington law is not well developed on the issue of the effect of foreclosure on a junior lease. It is not entirely clear that a creditor foreclosing a mortgage or deed of trust has the option of leaving leases that are junior to the lien of the mortgage or deed of trust undisturbed by the foreclosure. It is possible that the result could be different in a judicial foreclosure than in a nonjudicial foreclosure.

In the context of a judicial foreclosure, the court in *Virges v. Gregory Company, Incorporated*, 97 Wash. 333, 166 Pac. 610 (1917) raised the possibility that a foreclosure might automatically terminate junior leases, but did not decide the question. See III *Washington Real Property Deskbook* § 46.14(10)(d) (1996). It did hold that no such automatic termination would occur prior to the end of the statutory redemption period. *Id.* and RCW 6.23.110(1). At least one commentator has predicted that, if the issue were presented, the Washington courts would follow the so-called "New York rule," which permits a foreclosing lender to pick and choose which subordinate leases it will terminate. Comment, *The Effect of a Mortgage Foreclosure on a Lease Executed Subsequent to the Mortgage*, 17 *Wash. L. Rev.* 37 (1942). In a judicial foreclosure, the lender should not join tenants it does not want to foreclose out as defendants in the foreclosure action and it should request that the court explicitly provide in the decree of foreclosure which junior leases will be foreclosed out and which will not.

In the case of a nonjudicial foreclosure, there is language in the deed of trust statute providing that a junior lease will be foreclosed out and terminated only if the tenant is formally given the notice of trustee's sale. See RCW 61.24.040(1)(b), (7) and (9) and .060. However, the express language of the statute relates only to tenants whose leases (or memoranda thereof) are of record and to certain residential tenants. It could be argued that other tenants' leases are foreclosed out even if the tenants are not given formal notice of the nonjudicial foreclosure. See generally IV *Washington Real Property Deskbook* § 48.10(6)(b) (1996).

The lender should carefully consider which leases are important to the project and should be made senior to the mortgage or deed of trust or made the subject of a subordination,

nondisturbance and attornment agreement providing that the lease will remain in effect after foreclosure and that the tenant will attorn to the purchaser at the foreclosure sale.

d. Tenant Security Deposits

A transferee of a property does not have an obligation to return a commercial tenant's security deposit paid to a predecessor owner of the property. *Mullendore Theatres, Inc. v. Growth Realty Investors Co.*, 39 Wash. App. 64, 66, 691 P.2d 970 (1984). Presumably, this would apply to a foreclosing lender. The case did not address the tenant's right to offset a security deposit against rent owing to the transferee for periods following the transfer.

Residential landlords are required to deposit tenant security deposits in a trust account. RCW 59.18.270 and 59.20.170. The statute also requires a landlord transferring the property to transfer the security deposits to the transferee and establishes the priority of the tenants' claims to those funds. *Id.*

e. Omitted Junior Lienholders

Where a foreclosing secured creditor mistakenly omits a junior lienholder from a foreclosure, it can "reforeclose" to name the junior lienholder and foreclose out its interest in the property. *U.S. Bank of Washington v. Hursey*, 116 Wash. 2d 522, 526, 806 P.2d 245 (1991).

2. Nonjudicial Foreclosure of Deeds of Trust

a. Procedure and Timeline for Foreclosure

RCW 61.24.030-.045 provides a series of notices that must be given in order to complete a nonjudicial foreclosure. Completing the procedure specified in the statute typically requires a minimum of approximately five months. Further, the sale may not be held less than 190 days after the date of default. RCW 61.24.040(8).

In addition to mailing the notices to the specified recipients by first-class and certified or registered mail, certain of the notices must be posted on the property (or served on its occupants), recorded and published twice in a legal newspaper in the county or counties where the property is located.

The sale must be held on a Friday (or if Friday is a legal holiday on the following Monday) between the hours of 9:00 a.m. and 4:00 p.m. at "any designated public place" in the county or counties where the property is located. RCW 61.24.040(5); RCW 6.21.050(1). The sale may be postponed by the trustee for up to a total of 120 days. RCW 61.24.040(6).

The purchaser at the sale is entitled to possession of the property 20 days after the sale. RCW 61.24.060. However, pursuant to a 2009 amendment, a tenant or subtenant in possession of residential real property (defined in RCW 61.24.005(13) to mean "property consisting solely of a single-family residence, a residential condominium unit, or a residential cooperative unit") at the time of a trustee's sale is entitled to 60 days' notice to vacate. *See Senate Bill 5810 § 4 (2009)*. That requirement is effectively superseded by the requirement under federal law that

residential tenants be given a 90 day notice to vacate under § 702 of the Protecting Tenants at Foreclosure Act of 2009, Pub. L. No. 110-26 (2009).

b. One-Action and Antideficiency Statutes

(i) In General.

Washington has “one-action” and “antideficiency” rules. The one-action rule is set forth primarily in RCW 61.12.120, which prohibits judicial foreclosure of a mortgage or deed of trust while any other action for the same debt is pending or is being executed upon and in RCW 61.24.030(4), which states that one of the prerequisites to exercise of the trustee’s power of nonjudicial sale under a deed of trust is that:

. . . no action commenced by the beneficiary of the deed of trust is now pending to seek satisfaction of an obligation secured by the deed of trust in any court by reason of the grantor’s default on the obligation secured: PROVIDED, That (a) the seeking of the appointment of a receiver shall not constitute an action for purposes of this chapter; and (b) if a receiver is appointed, the grantor shall be entitled to any rents or profits derived from property subject to a homestead as defined in RCW 6.13.010. If the deed of trust was granted to secure a commercial loan, this subsection shall not apply to actions brought to enforce any other lien or security interest granted to secure the obligation secured by the deed of trust being foreclosed;

In *American Federal Savings & Loan Association of Tacoma v. McCaffrey*, 107 Wash. 2d 181, 189, 728 P.2d 155 (1986), the Washington Supreme Court stated in dicta that a judicial foreclosure is permissible after completion of a suit on the note secured by a mortgage or deed of trust and does not violate the one action rule:

The mortgagee may sue and obtain a judgment upon the notes and enforce it by levy upon any property of the debtor. If the judgment is not satisfied in this manner, the mortgagee still can foreclose on the mortgaged property to collect the balance. Alternatively, the mortgagee may foreclose on the mortgaged property and obtain a deficiency judgment....Concurrent actions to obtain execution of a judgment and foreclose on the mortgaged property are prohibited.

Id. The court in *Hanna v. Kasson*, 26 Wash. 568, 571-72, 67 Pac. 271 (1901) held to the same effect. The same procedure is permitted in the nonjudicial foreclosure context. RCW 61.24.100(2).

The antideficiency rule applicable to nonjudicial deed of trust foreclosures is set forth in RCW 61.24.100, which provides in pertinent part:

Except to the extent permitted in this section for deeds of trust securing commercial loans [“commercial loan” is defined in RCW 61.24.005(7) to mean a loan that “is not made primarily for personal, family or household

purposes”] 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.

(ii) ***Cross-Collateralization Risks.***

Because of the deficiency waiver aspect of Washington’s deed of trust statute, lenders must be very cautious about using “dragnet” or cross-collateralization clauses in Washington deeds of trust. Take the example of a bank making a home loan to a borrower who also has a credit card and a commercial real estate loan secured by an apartment building from the same bank. If the deed of trust securing the home loan were to state that it secures all obligations owed to the bank and the bank were to foreclose it nonjudicially, the effect would be to satisfy all obligations owing on all three debts and to preclude foreclosure of the bank’s lien on the apartment building (the provisions of RCW 61.24.100(3)(b) permitting foreclosure on other security would not apply in this example because the foreclosed deed of trust did not secure a commercial loan).

(iii) ***Exceptions to Antideficiency Rule.***

Several rather complex exceptions to the antideficiency rule are set forth in RCW 61.24.100, which was amended substantially in 1998 to add the exceptions. Most of them apply only to deeds of trust securing commercial loans. The statute does not explicitly address the situation where the deed of trust secures both commercial and non-commercial loans and there is no reported case law dealing with that situation. The exceptions include:

(A) ***Waste and Wrongful Retention of Funds.*** Claims against the borrower or grantor for damages for waste to the property committed after the deed of trust was granted or for wrongful retention of rents, insurance proceeds or condemnation awards by the borrower or grantor that are otherwise owed to the beneficiary. This exception applies only to deeds of trust securing commercial loans and does not apply to any property that is occupied by the borrower as his or her principal residence on the date of the trustee’s sale. Any action under this provision must be brought within one year after the date of the trustee’s sale under the deed of trust (or in the case of multiple trustee’s sales on deeds of trust securing the same obligation, the latest of those sales). RCW 61.24.100(4). The one-year period is tolled by the period of any relevant stay in bankruptcy or other insolvency proceedings. *Id.*

(B) ***Other Collateral.*** Judicial or nonjudicial foreclosure on any other real or personal property security for the obligations secured by the deed of trust that was the subject of the nonjudicial trustee’s sale, but only if that deed of trust secured a commercial loan. RCW 61.24.100(3)(b).⁴

(C) ***Guarantors.*** An action for a deficiency judgment against a guarantor. Such an action is subject to the same one-year statute of limitation that applies to

⁴ A similar, but not identical exception existed under case law prior to the 1998 amendments to RCW 61.24.100. *Donovick v. Seattle-First National Bank*, 111 Wash. 2d 413,757 P.2d 1378 (1988). The continued effect of the *Donovick* case after these amendments on situations that are not within the express scope of the exception in RCW 61.24.100(3)(b) is unclear.

actions for waste or wrongful retention of funds described in paragraph (A) above. However, this exception applies only to deeds of trust securing commercial loans and there are some important further limitations on the right to deficiency judgments against guarantors:

Fair Value Limitation. The guarantor has the right to have the court or other adjudicator determine the “fair value” of the property (and of any other previously sold collateral securing the same debt) and to have the deficiency calculated on the basis of the greater of that fair value or the amount bid at the trustee’s sale. RCW 61.24.100(5).

Secured Guaranties. A deficiency judgment is *not* available against a guarantor that is the grantor of a deed of trust to secure the guaranty except to the extent of any waste or wrongful retention of funds as described in paragraph (A) above. RCW 61.24.100(6).

Homestead Right re Guaranties Secured by Principal Residence. If the guaranty is secured by a deed of trust on the guarantor’s principal residence, the guarantor is entitled to be paid an amount equal to the homestead exemption provided for in RCW 6.13.030 “from the bid at the foreclosure sale.” RCW 61.24.100(6). How this provision would be applied in the case of a credit bid by the foreclosing creditor is not specified in the statute and has not been determined by case law.

Notices to Guarantor. The guarantor must be given the notices specified in RCW 61.24.042.

(D) ***Unsecured Indemnities and Other Unsecured Obligations.*** An action to collect or enforce any obligation of a borrower or guarantor if that obligation, ***or the “substantial equivalent” of that obligation,*** was not secured by the deed of trust is not barred by a nonjudicial trustee’s sale. RCW 61.24.100(10). This provision probably makes it possible to recover on an unsecured environmental indemnity after a nonjudicial foreclosure of the related deed of trust so long as the substantial equivalent of the indemnity was not secured by the deed of trust. Although some lenders use secured environmental indemnities on properties in Washington, unsecured indemnities are more common. Of course, one disadvantage of using an unsecured indemnity is that, if the lender incurs costs reimbursable under the indemnity prior to a foreclosure sale, the borrower’s obligation to reimburse those costs is not secured and cannot be added to the lender’s credit bid at a nonjudicial trustee’s sale. The lender should be able to enforce a properly drafted unsecured indemnity after a nonjudicial foreclosure of a deed of trust securing a commercial loan.⁵ Because of the “substantial equivalent” language in the statute, a lender using an unsecured environmental indemnity should ensure that no substantially equivalent environmental obligations are contained in the deed of trust or in other loan documents secured by the deed of trust. Where an unsecured indemnity is used, the loan documents should clearly state that, notwithstanding anything to the contrary, no obligation set out in the indemnity agreement, and no substantial equivalent of any such obligation, shall be secured by the deed of trust. That should prevent, for example, a situation in which a general indemnity provision or general provision requiring compliance with applicable

⁵ Oddly, the RCW 61.24.100(10) exception is, by its terms, applicable only to commercial loans; however, there is nothing in the basic antideficiency rule of RCW 61.24.100(1) that would limit the enforceability of obligations *not* secured by a deed of trust securing a non-commercial loan after nonjudicial foreclosure of that deed of trust.

laws might be deemed to be the substantial equivalent of the indemnity obligations that are meant to be unsecured.

(E) ***Guarantors' Subrogation Rights.*** The deed of trust statute does not impair the right of a guarantor against which a deficiency judgment has been obtained from enforcing any right of reimbursement that guarantor may have against the borrower. RCW 61.24.100(11). This provision is applicable to deeds of trust securing non-commercial loans as well as commercial loans. The statute does not address the question of whether the lender can take a security interest in the guarantor's reimbursement rights and then enforce them against the borrower.

(F) ***Miscellaneous Exceptions.*** Additional exceptions to the antideficiency rule have been recognized in case law. *Meyers Way Development Limited Partnership v. University Savings Bank*, 80 Wash. App. 655, 910 P.2d 1308 (1996) (nonjudicial trustee's sale did not preclude action to recover a deficiency judgment for conversion of a portion of the encumbered property from third parties who were not obligors of the debt secured by the deed of trust); *Glenham v. Palzer*, 58 Wash. App. 294, 792 P.2d 551 (1990) (nonjudicial trustee's sale did not preclude fraud action against non-obligors who induced beneficiaries to enter into loan transaction secured by the deed of trust even though beneficiaries made full credit bid at trustee's sale); *Carter v. Derwinski*, 987 F.2d 611 (9th Cir. 1993) (Veterans Administration retains right of indemnity under federal regulation against grantor/borrower of VA-guaranteed loan despite release of deficiency liability under state foreclosure law).

c. Right to Cure Defaults

RCW 61.24.090 allows various parties the right to cure defaults on obligations secured by a deed of trust, reinstate the obligations and cause a cancellation of the nonjudicial foreclosure sale. The cure may be made any time prior to 11 days before the scheduled date of the trustee's sale or any continuance thereof and without regard to any acceleration of the loan balance. As a result of this provision, a lender with a borrower who repeatedly defaults and reinstates can be certain of permanently accelerating the loan only if it uses the judicial foreclosure process.

The reinstatement of some types of obligations under the statute may be problematic. For example, it is not uncommon for certain types of lenders to enter into an interest rate swap with the borrower and to secure the swap obligations with the deed of trust securing the loan. Where such an interest rate swap is terminated due to a default, it may not be practical or fair to reinstate the swap. For an analysis of this issue under comparable provisions of California law, see Harvey, *Securing Derivatives Obligations With California Real Estate*, 3 *Hastings Business Law Journal* 251, 262-66 (2007).

d. Restraint of Trustee's Sale

RCW 61.24.130 provides the procedure for seeking to restrain a nonjudicial trustee's sale. The party seeking to restrain the sale is required to pay to the clerk of the court every thirty days the principal, interest and reserves coming due or, if the default consists of failure to pay an obligation that is then fully payable by its terms, the interest accruing monthly at the nondefault rate. RCW 61.24.130(1). In the case of a commercial loan, failure to obtain an injunction

restraining the sale results in a waiver of all defenses to the underlying debt, but not of all defenses based on irregularities at the sale itself. *CHD, Inc. v. Boyles*, 138 Wash. App. 131, 139, 157 P.3d 415 (2007).⁶ It is unclear whether a money damages claim by a borrower that unsuccessfully attempts to obtain an injunction could prevail at an ultimate trial on its claim yet be barred from obtaining relief as a result of having failed to obtain an injunction. *Brown v. Household Realty Corporation*, 146 Wash. App. 157, 189 P.3d 233 (2008).

e. Irregularities in Trustee's Sale; Post-Sale Matters

Despite the requirement that the lender strictly comply with the provisions of the deed of trust statute, “a plaintiff must show prejudice before a court will set aside a trustee sale” for irregularities. *Amaresco Independence Funding, Inc. v. SPS Properties, LLC*, 129 Wash. App. 532, 536-37, 119 P.3d 884 (2005).

RCW 61.24.040(6) provides that the trustee’s deed “shall recite the facts showing that the sale was conducted in compliance with all of the requirements of this chapter and of the deed of trust, which recital shall be prima facie evidence of such compliance and conclusive evidence thereof in favor of bona fide purchasers and encumbrances for value” except for holders of liens or interests who were not given the required foreclosure notices.

RCW 61.24.050 mandates that a trustee deliver the trustee’s deed to the purchaser “absent a procedural irregularity that voids the sale.” *Udall v. T.D. Escrow Services, Inc.*, 159 Wash. 2d 903, 909, 154 P.3d 882 (2007). Examples of irregularities sufficient to void the sale include sales in violation of the automatic stay in bankruptcy and a nonjudicial trustee’s sale held while a lawsuit is pending on the obligation secured by the deed of trust. *Id.* at 911. Insufficiency of the price paid at the sale is not enough to void the sale. *Steward v. Good*, 51 Wash. App. 509, 514, 754 P.2d 150 (1988). This is true even if the low price results from a clerical error by the creditor or its agent in accidentally bidding a lower amount at the sale than it intended. *Udall v. T.D. Escrow Services, Inc.*, *supra*, at 159 Wash. 2d 914-15.

Once the trustee’s deed has been delivered to the purchaser, the grantor no longer has any interest in the property. RCW 61.24.050. If the grantor files for bankruptcy after delivery of the deed to the purchaser, the property is not property of the bankruptcy estate even if the purchaser has not recorded the deed when the bankruptcy is filed. *In re Bell*, 386 B.R. 282, 292 (W.D. Wash. 2008).

f. Multiple Properties/Counties

Where a loan is secured by multiple properties located in Washington, it is permissible to encumber all of them with a single deed of trust even if they are located in different counties and are not contiguous to one another. *Queen City Savings & Loan Association v. Mannhalt*, 111 Wash. 2d 503, 760 P.2d 350 (1988); *27 Washington Practice* § 3.65 (1998). The trustee may hold a single trustee’s sale under such a deed of trust in any one of the counties in which one or more of the properties is located. *Id.* A similar approach applies in the case of mortgages and judicial foreclosure. See Section VI.O.3.f of this guide.

⁶ Somewhat different rules apply to a non-commercial loan secured by owner-occupied residential real property pursuant to a 2009 amendment to the deed of trust statute. See Senate Bill 5810 § 6 (2009).

g. Junior Liens in Nonjudicial Foreclosure

A junior lienholder does not have an obligation to mitigate its damages when a senior lien is foreclosed by bidding at the senior lienholder's foreclosure sale and capturing any excess value that may exist over the balance owed to the senior lienholder. *Metropolitan Mortgage & Securities Co., Inc. v. Becker*, 64 Wash. App. 626, 631, 825 P. 2d 360 (1992).

The nonjudicial foreclosure of a senior deed of trust does not preclude an action by a nonforeclosing holder of a junior deed of trust to recover on a debt secured by that junior deed of trust. *Beal Bank, SSB v. Sarich*, 161 Wash. 2d 544, 550, 167 P.3d 555 (2007).⁷

3. Judicial Foreclosure of Mortgages and Deeds of Trust

Mortgages can only be foreclosed judicially. RCW 61.12.040. A deed of trust can be foreclosed judicially if the lender wants to obtain a deficiency judgment not permitted after a nonjudicial sale. RCW 61.24.100(8). RCW 61.12.120 contains the one-action rule applicable to judicial foreclosures, which precludes a separate action on the secured debt while the foreclosure is proceeding. However, such actions are permitted before the foreclosure if they are completed prior to the commencement of the foreclosure. *American Federal Savings & Loan Association of Tacoma v. McCaffrey*, 107 Wash. 2d 181, 189, 728 P.2d 155 (1986).

a. Right of Redemption

Washington has a complex statutory right of redemption for mortgages and judicially foreclosed deeds of trust. RCW chapter 6.23. A good description of Washington's "scramble" redemption system, which is very similar to California's, is given in *Capital Investment Corporation of Washington v. King County*, 112 Wash. App. 216, 221-22, 47 P.3d 161 (2002).

The debtor is permitted to redeem the property for up to one year after confirmation of the sale. In the case of nonagricultural property as to which the creditor has waived its right to a deficiency, the redemption period is eight months. RCW 6.23.020. There is no redemption

⁷ The *Beal Bank* court declined explicitly to overrule *Washington Mutual Savings Bank v. United States*, 115 Wash. 2d 52, 793 P.2d 969 (1990), *opinion clarified at* 800 P.2d 1380 (1990), an odd and much-criticized case involving some unusual facts, in which the Washington Supreme Court appeared to hold that the nonjudicial foreclosure of a senior deed of trust operates to satisfy not only the debt secured by the foreclosed deed of trust, but also the debt secured by all junior liens on the property. However, the *Beal Bank* case appears to undercut any remaining authority the *Washington Mutual* case may have had. In its initial opinion, the court in the *Washington Mutual* case stated: "We do not deem it necessary to determine how a deficiency judgment should be measured in this case since we hold here that none may be obtained by a nonforeclosing junior lienor following a nonjudicial, or deed of trust, foreclosure [which, in this case, was of a senior lien]." 793 P.2d at 792. Subsequently, the court filed a "clarification" of the ruling which added the following sentence to the majority opinion: "We do not herein address the matter of a junior deed of trust holder's continued right to sue the debtor on the promissory note because it is not before us." 800 P.2d 1124. The court did not explain how it considered suing for a deficiency to be different from suing on the promissory note in the context of a foreclosed out junior lienholder, so the clarification further confused the situation. The case did not address the effect of a waiver by the junior lienholder of its security prior to the foreclosure of the senior deed of trust. For critiques of the *Washington Mutual* case, see , Rights of Washington Junior Lienors in Nonjudicial Foreclosure, 67 *Wash. L. Rev.* 235 (1992); and 18 *Washington Practice* § 19.17 (2004). See also *DeYoung v. Cenex Ltd.*, 100 Wash. App. 885, 894-95, 1 P.3d 587 (2000) (junior lienholder foreclosed out in judicial foreclosure is not precluded from suing on debt as a result of redeeming).

period for nonagricultural improved property that has been abandoned for six months or more where the lender does not seek a deficiency judgment. RCW 61.12.093-.095. The redemption period may be extended in certain circumstances. *See* RCW 6.23.030(2) (six-month extension for failure to give notice of expiration of redemption period), RCW 6.23.040(1) (60-day extension(s) for successive redemptions), RCW 6.23.090(2) (extension where verified statement of rents, profits, and expenses is requested).

The redemption price is the amount of the successful bid at the foreclosure sale plus interest thereon at the rate provided in the judgment and certain other amounts as provided in RCW 6.23.020(2).

The purchaser at the foreclosure sale is entitled to possession of the property during the redemption period unless the property is a homestead or is used for farming purposes. RCW 6.23.110(3) and (4). Tenants under unexpired leases may remain in possession during the redemption period, but the purchaser is entitled to the rent under the lease. RCW 6.23.110(1).

Until the redemption period has run, it is generally not feasible to sell the property or to make non-trivial improvements.

Redemption rights may not effectively be waived in the mortgage or deed of trust, but may be waived after a default has occurred. *Batten v. Fallgren*, 2 Wash. App. 360, 362, 467 P.2d 882 (1970). A mortgagor or redemptioner may transfer the right of redemption, but only by means of a deed sufficiently conveying both the redemption right and the grantor's underlying interest in the property that gave rise to the redemption right. *Fidelity Mutual Savings Bank v. Mark*, 112 Wash. 2d 47, 52-53, 767 P.2d 1382 (1989); *Capital Investment Corp. of Washington v. King County*, 112 Wash. App. 216, 47 P.3d 161 (2002). As illustrated by the *Capital Investment* case, great care must be taken in structuring and documenting transfers of redemption rights in order to make them effective.

Although federal law generally governs loans made by agencies of the federal government, it has been held that Washington's redemption provisions apply to judicial foreclosures by the federal government on Washington property as a matter of federal common law. *United States v. Ellis*, 714 F.2d 953 (9th Cir. 1983). However, this result may have been called into question by later developments, at least as to some branches of the federal government. *See United States v. Einum*, 992 F.2d 761 (7th Cir. 1993).

b. Right to Cure Defaults

RCW 61.12.130 allows the defendant in a judicial foreclosure to obtain a stay of the foreclosure by paying into court the principal and interest then due, with costs. However, where the principal balance has been accelerated, the entire principal balance is deemed to be due and this statute cannot be used to undo the acceleration. *Knisell v. Brunet*, 60 Wash. 610, 613, 111 Pac. 894 (1910); 18 *Washington Practice* § 19.1 (2d ed. 2004).

c. Effect of Foreclosure on Junior Leases

See Section VI.O.1.c of this guide for a discussion of the effect of a judicial foreclosure on leases subordinate to the foreclosed deed of trust or mortgage.

d. Upset Price

An upset price procedure is available under RCW 61.12.060. If the court finds that procedure to be appropriate, it can determine the “fair value of the property” and require that the fair value be credited against the debt notwithstanding a lower successful bid at the foreclosure sale. “Fair value” has been defined as the amount that a competitive bidder would consider to be a “fair bid at the time of sale under normal conditions.” *National Bank of Washington v. Equity Investors*, 81 Wash. 2d 886, 926, 506 P.2d 20 (1973). The court can set an upset price at any time up to the time of the hearing on confirmation of the foreclosure sale. Before the court can set an upset price, it must determine that an upset price is appropriate “based upon economic conditions or peculiarities of the mortgaged property” and a finding that “there will be no true competitive bidding.” *American Federal Savings & Loan Association of Tacoma v. McCaffrey*, 107 Wash. 2d 181, 187-88, 728 P.2d 155 (1986).

e. Jury Trial

Foreclosure of a real or personal property lien is an equitable action for which the trial court has discretion whether to allow a jury trial. *Puget Sound National Bank of Tacoma v. Olsen*, 174 Wash. 200, 202-203, 24 P.2d 613 (1933).

f. Environmental Indemnities, Etc.

A lender foreclosing judicially should consider whether the judgment and decree of foreclosure should expressly provide that any environmental indemnity or other indemnity will survive the foreclosure, especially if the indemnity is secured by the mortgage or deed of trust. Absent such a provision, the loan obligations may be merged into the judgment and not be separately enforceable later. *See generally Woodcraft Construction, Inc. v. Hamilton*, 56 Wash. App. 885, 888, 786 P.2d 307 (1990)

g. Multiple Properties/Counties

A single mortgage or deed of trust covering multiple parcels of property cannot be foreclosed piecemeal in separate judicial foreclosure actions and a mortgagee that forecloses on only a part of the property will be deemed to have waived its right to foreclose on the remainder. *Tacoma Savings Bank & Trust Company v. Safety Investment Company*, 123 Wash. 481, 212 Pac. 726 (1923) and cases cited therein. However, multiple mortgages or deeds of trust securing the same debt can be foreclosed individually without waiver of the right to foreclose on the others. *Id.*

When one or more mortgages or deeds of trust securing the same debt cover properties in more than one county, all the properties may be foreclosed upon in a single judicial foreclosure action in one of the counties, even if the properties are not contiguous. RCW 61.12.040; *Commercial National Bank of Seattle v. Johnson*, 16 Wash. 536, 544, 48 Pac. 267 (1897).

4. Forfeiture of Real Estate Contracts

The procedure for forfeiture of real estate contracts is set out in RCW 61.30. Because real estate contracts are no longer widely used, they are not discussed in detail in this guide.

5. Deeds in Lieu of Foreclosure

Deeds in lieu of foreclosure given after a default are common in Washington; however, there are several pitfalls of which the creditor accepting such a deed should be aware.

a. Junior Liens

A deed in lieu of foreclosure does not have the effect of eliminating junior liens. Therefore, senior lenders usually prefer to foreclose rather than to accept a deed in lieu if there are junior liens on the property. If the lender accepts a deed in lieu knowing of junior liens, it may be argued that the lender accepted the property subject to the junior liens and does not have the right later to foreclose them out. *See generally Restatement (Third) of Property (Mortgages) § 8.5 (1997)*. However, Washington law does not support such an outcome, at least in the absence of evidence that such was the intention of the parties. *See Gill v. Strouf*, 5 Wash. 2d 426, 105 P.2d 829 (1940); *Altabet v. Monroe Methodist Church*, 54 Wash. App. 695, 777 P.2d 544 (1989).

b. Merger Issues

There is a risk that a court may merge the lender's deed of trust or mortgage into the newly acquired fee title; however, because merger is a question of intent, this risk can be minimized by appropriate drafting. *See U.S. Bank of Washington v. Hursey*, 116 Wash. 2d 522, 528 n.2, 806 P.2d 245 (1991); *Altabet v. Monroe Methodist Church*, 54 Wash. App. 695, 777 P.2d 544 (1989). The lender accepting a deed in lieu generally will want to keep its lien in effect so that it can be foreclosed later if necessary due to undiscovered junior liens. Title insurance companies will often issue a non-merger endorsement insuring the continued validity of the deed of trust or mortgage after a deed in lieu.

c. Redemption Rights

One early case held that, where a mortgagee takes a deed in lieu of foreclosure and there is a junior lien on the property, the junior lienholder has a right to redeem the property from the grantee of the deed in lieu even if the junior mortgage is not recorded. *Malm v. Griffith*, 109 Wash. 30, 186 Pac. 647 (1919).

d. Recharacterization as a Mortgage

A mortgagee accepting a deed in lieu should be cautious in entering into a deed in lieu transaction with features that suggest the continued existence of a creditor-debtor relationship between the parties that could lead a court to recharacterize the deed as a mortgage rather than as an effective transfer of fee title. *See, e.g., Pittwood v. Spokane Savings & Loan Society*, 141 Wash. 229, 251 Pac. 283 (1926); *Johnson v. National Bank of Commerce*, 65 Wash. 261, 118 Pac. 21 (1911); *Swarm v. Boggs*, 12 Wash. 246, 40 Pac. 941 (1895). Such factors, no one of which is determinative, include the giving of an option to repurchase, a lease back of the property, a property value that greatly exceeds the secured debt, and continued payment of costs of the property by the grantor after the transfer. *Id.*

For a case in which the court did hold that a “deed in lieu” (actually a transfer of pledged corporate stock to the secured creditor) was ineffective as an absolute transfer and that the creditor-debtor relationship continued, see *Collins v. Denny Clay Co.*, 41 Wash. 136, 82 Pac. 1012 (1905). In that case, the value of the collateral transferred greatly exceeded the secured debt, there was an option to repurchase the collateral, and there was a provision in the agreement that, if the transferor did not exercise the option to repurchase, the promissory note would continue in effect.

A contention that a deed in lieu should be treated as a mortgage must be proved by clear and convincing evidence. *Pittwood, supra*, at 141 Wash. 233.

e. Liability for Deficiency

At least one case has held that a lender cannot take a deed in lieu of foreclosure and maintain the personal liability of the borrower for the debt because such a procedure is a circumvention of the antideficiency provisions of the deed of trust statute. *Thompson v. Smith*, 58 Wash. App. 361, 793 P.2d 449 (1990). But see *Altabet, supra*, for a contrary view. Both cases dealt with situations in which the documents executed by the parties did not clearly address the borrower’s liability for the debt after delivery of the deed. Further, *Thompson v. Smith* involved a situation where the creditor took a deed in lieu from the current owner of the property and later sought to obtain a judgment against the original obligor on the debt, who had previously transferred the property. The court held that the creditor “essentially carried out a nonjudicial foreclosure without having to follow the procedures of RCW 61.24” and held that the obligor was entitled to the protection of the antideficiency law. *Thompson v. Smith*, 58 Wash. App. at 366.

RCW 61.24.100(7) provides that a beneficiary’s acceptance of a deed in lieu of foreclosure securing a commercial loan exonerates guarantors of the loan from liability on the loan except to the extent they otherwise agree as part of the deed in lieu transaction.

f. Impairment of Subrogation Rights

MGIC Financial Corporation v. Briggs Company, 24 Wash. App. 1, 600 P.2d 573 (1979), involved a beneficiary that took a deed in lieu of foreclosure of some, but not all, of the parcels encumbered by a deed of trust and released its borrower from liability on the secured debt. It later tried to foreclose out the interest of a transferee of a parcel that was not conveyed by the deed in lieu. The court held that the beneficiary had impaired the subrogation rights of the transferee by releasing the original borrower and thereby discharged the lien of the deed of trust on the transferred parcel.

g. Real Estate Excise Tax

As discussed in Section III.C.3 above, Washington’s real estate excise tax is generally not payable on a deed in lieu of foreclosure to the extent that the consideration for the deed consists of forgiveness of the debt secured by the property conveyed. RCW 82.45.010(3). However, where a deed in lieu of foreclosure is given on a junior lien mortgage or deed of trust, the tax is payable on the outstanding principal amount of any senior lien that is not satisfied by the deed.

WAC 458-61A-208(3)(d)(iii). That tax can be avoided by foreclosing the junior lien rather than taking a deed in lieu. WAC 458-61A-208(4).

6. Past Due Rents Collected After Foreclosure

Where rents from tenants are past due and uncollected at the time of a foreclosure sale, the buyer at the foreclosure sale is entitled to collect them rather than the foreclosed out former owner regardless of whether the rents are mentioned specifically in the foreclosure documents. *Kezner v. Landover Corporation*, 87 Wash. App. 458, 466-67, 942 P.2d 1003 (1997). The same should be true in the case of a deed in lieu of foreclosure under the reasoning of the *Kezner* case.

7. Mortgagee in Possession Status

A lender is not entitled to possession of the property prior to completion of a foreclosure of its deed of trust or mortgage. RCW 7.28.230(1). If it takes possession prior to a foreclosure sale, it may become subject to liability for certain torts under concepts of premises liability. *Coleman v. Hoffman*, 115 Wash. App. 853, 64 P.3d 65 (2003). Merely collecting the rent from the property does not make the lender a mortgagee in possession with such liability. *Id.* at 115 Wash. App. 863.

An older case held a mortgagee in possession liable for rent to the borrower. *Howard v. Edgren*, 62 Wash. 2d 884, 385 P.2d 41 (1963). That result should not occur today, at least if the lender has an assignment of the rents of the property, because RCW 7.28.230 was amended in 1969 to validate such assignments.

There is a more complete discussion of Washington law on mortgagees in possession in 18 *Washington Practice* § 18.7 (2d ed. 2004).

P. Environmental Indemnities

Although some lenders use secured environmental indemnities on properties in Washington, unsecured indemnities are more common. The lender should be able to enforce a properly drafted unsecured indemnity after a nonjudicial foreclosure of a deed of trust securing a commercial loan because a “trustee’s sale under a deed of trust securing a commercial loan does not preclude an action to collect or enforce any obligation of a borrower or guarantor if that obligation, or the substantial equivalent of that obligation, was not secured by the deed of trust.” RCW 61.24.100(10). Because of the “substantial equivalent” language in the statute, a lender using an unsecured environmental indemnity should ensure that no similar environmental obligations are contained in the deed of trust or in other loan documents secured by the deed of trust.

Q. Construction Liens

Mechanic’s and material supplier’s liens are provided for in RCW chapter 60.04. The lien can be claimed by “any person furnishing labor, professional services, materials, or equipment for the improvement of real property.” RCW 60.04.021. The term “professional services”, as used in the lien law, covers only “surveying, establishing or marking the boundaries of, preparing maps, plans, or specifications for, or inspecting, testing or otherwise performing

any other architectural or engineering services for the improvement of real property.” RCW 60.04.011(13).

A claim of lien must be filed within 90 days after the lien claimant ceases to furnish labor, professional services, materials or equipment to the project in order to perfect the lien. RCW 60.04.091. The lien expires if the lien claimant does not file an action to foreclose it within eight months after the lien is recorded and serve the owner of the property within 90 days after filing the action. RCW 60.04.141. If the lien claimant fails to prosecute such an action to judgment within two years, the court may dismiss it for want of prosecution; however the two year period is tolled by the filing of bankruptcy by the owner. RCW 60.04.141.

Generally, construction liens are prior to any deed of trust, mortgage or other lien recorded after “the time of commencement of labor or professional services or first delivery of materials or equipment by the lien claimant.” RCW 60.04.061. The priority of construction liens securing different types of lien claims is set out in RCW 60.04.181.

The prevailing party in a lien foreclosure action is entitled to an award of its attorneys’ fees. RCW 60.04.181(3).

Certain claimants of liens for professional services, materials or equipment who do not contract directly with the owner must give a preclaim notice as provided in RCW 60.04.031.

RCW 60.04.255 requires that “real property lenders” give certain informational materials prepared by the state Department of Labor and Industries “to all persons obtaining loans, the proceeds of which are to be used for residential construction or residential repair or remodeling.” Apparently, the materials are contained in Department of Labor and Industries publication no. F625-017-000. While the statute appears to be directed at consumer loans on single family properties, it could be argued that it applies to construction loans on multifamily projects, condominium projects or multiple homes in a subdivision. Subsection (3) expressly provides that no cause of action may lie against a lender arising from the provisions of the statute.

RCW 60.04.221 contains Washington’s “stop notice” law. It permits a lien claimant to give a construction lender a notice that the lien claimant has not been timely paid. The lender is then required to withhold from draws under the construction loan the amount claimed to be due in the notice. The stop notice procedure does not apply if there is a payment bond of fifty percent or more of the amount of the construction financing.

Washington, unlike California and some other states, does not have a statutory form of lien waiver/release. It does have a statute requiring that, upon demand of the owner or the person making payment, a lien claimant “shall immediately prepare and execute a release of all lien rights for which payment has been made, and deliver the release to the person making payment.” RCW 60.04.071.

Provisions for bonding over construction liens are set forth in RCW 60.04.161.

Washington’s lien law does not apply to federal or state property. *See IV Washington Real Property Deskbook* § 65.2(1) (1996).

A party that fails properly to perfect or pursue its lien rights may still be able to recover from a construction lender on an unjust enrichment theory under certain circumstances. *See, e.g., Town Concrete Pipe of Washington, Inc. v. Redford*, 43 Wash. App. 493, 717 P.2d 1384 (1986); *Irwin Concrete, Inc. v. Sun Coast Properties, Inc.*, 33 Wash. App. 190, 653 P.2d 1331 (1982). The lender is particularly at risk of such a claim where it actively encouraged the work during a default situation or foreclosed on a completed project without having fully advanced the construction loan

In *Westview Investments, Ltd. v. U.S. Bank National Association*, 133 Wash. App. 835, 138 P.3d 638 (2006), the court held that payments received by a contractor from an owner are subject to an express trust in favor of subcontractors and the contractor's bank cannot offset against funds in the contractor's account to apply to the bank's loan to the contractor if it has actual knowledge of the trust nature of the funds or "knowledge sufficient to necessitate inquiry concerning the sums."

R. Homestead

Washington's homestead law is set forth in Article 19, Section 1 of the state constitution and in RCW chapter 6.13. The amount of the homestead exemption is generally \$125,000 (although different amounts apply in certain specialized situations). RCW 6.13.030. That amount was increased from \$40,000 by the legislature in 2007. Spouses cannot double the amount of the homestead exemption by claiming homestead rights in the same property, but they may be able to do so by occupying separate properties as homesteads. *See* RCW 6.13.020; 1 *Washington Practice* § 12.12 (4th ed. 1997).

The homestead exemption applies to real or personal property that the owner uses as a residence without the need to file a declaration of homestead. RCW 6.13.010 and .040(1). To claim the exemption with respect to property that is not occupied as the owner's residence, it is necessary to file or deliver a declaration of homestead as provided in RCW 6.13.040 and 6.15.060.

Certain types of debts with respect to which the homestead exemption cannot be claimed are set out in RCW 6.13.080. Generally, the homestead exemption cannot be claimed as against a secured creditor holding a deed of trust, mortgage or security agreement on the homestead property (whether a first lien or a junior lien). RCW 6.13.080(2); *Felton v. Citizens Federal Savings and Loan Association of Seattle*, 101 Wash. 2d 416, 679 P.2d 928 (1984); *Household Finance Industrial Loan Company v. Upton*, 102 Wash. App. 220, 6 P.3d 1231 (2000). A notable exception is contained in RCW 61.24.100(6), which provides that: "If the deed of trust [securing a guaranty of a commercial loan] encumbers the guarantor's principal residence, the guarantor shall be entitled to receive an amount up to the homestead exemption set forth in RCW 6.13.030, without regard to the effect of RCW 6.13.080(2), from the bid at the foreclosure or trustee's sale accepted by the sheriff or trustee prior to the application of the bid to the guarantor's obligation." The statute does not address the issue of how it would be applied in a situation in which the beneficiary of the foreclosed deed of trust buys the property at the trustee's sale by credit bidding its secured debt.

In the case of a judicial foreclosure, the owner is allowed to stay in the homestead property until the expiration of the redemption period “without accounting for issues or for value of occupation.” RCW 6.23.110(4).

Superior court judgments generally become liens on real property of the judgment debtor located in the same county as the court with priority as of the date the court enters the judgment. RCW 4.56.200. However, the judgment creditor must take the extra step of recording the judgment in the real estate records in order for the judgment lien to attach to the excess value of homestead property over and above the amount of the homestead exemption. RCW 6.13.090. For a discussion of some of the intricacies of this rule, see *In re DeLavern*, 337 B.R. 239 (Bankr. W.D. Wash. 2005).

Research has not revealed any Washington law on the question of whether the homestead exemption can be waived in advance by contract with a creditor. One general treatise, which does not deal with Washington law specifically, states:

Although there is authority to the contrary, it has been held that homestead rights may generally be waived by a proper person. Waiver may generally be done in a deed or mortgage.

40 *Am. Jr. 2d Homestead* § 179 (2008). However, a Washington court could hold that homestead rights are not waivable or are only waivable after default, as is the case with waivers of redemption rights in judicial foreclosure. See Section VI.O.3.a of this guide.

S. Leasehold Financing

Washington has little law specific to the situation in which a lender’s collateral is the lessee’s interest under a ground lease or other lease. Generally, a deed of trust is the preferred security instrument for encumbering a leasehold interest.

A deed of trust or mortgage on a leasehold should clearly state that it encumbers the leasehold. In *National Bank of Commerce v. Fountain*, 9 Wash. App. 721, 514 P.2d 188 (1973), the court held that a mortgage executed by a farmer was effective to encumber only the mortgagor’s five-eighths remainder interest in the property and was not effective to encumber his interest as lessee under a 40-year land lease of the entire property because the mortgage did not expressly refer to the lease.

Washington courts have enforced so-called “subordinated fee” leasehold financing transactions (*i.e.*, loans in which only the lessee of the property is personally obligated on the loan, but both the lessee and the lessor encumber their interests in the property to secure the loan). See *Seattle-First National Bank v. Hart*, 19 Wash. App. 71, 573 P.2d 827 (1978). In such transactions, the loan to the lessee is deemed sufficient consideration to support the grant of a lien on the lessor’s interest and no separate consideration needs to flow to the lessor. *Id.* at 19 Wash. App. 73. The Washington Supreme Court has held that a lessor in such transactions that benefits directly from the loan (*e.g.*, by improvement of its property with the proceeds of the loan) is not a guarantor or surety with respect to either the lender or the ground lessee. *Honey v. Davis*, 131 Wash. 2d 212, 930 P.2d 908 (1996). As a result, the Lessor may not be entitled to a

guarantor's common law rights of reimbursement, subrogation, etc. and should consider seeking similar rights by contract.

T. Tenant in Common Ownership and Partition

Lenders on properties owned by multiple owners as tenants in common are often concerned about the effect on the loan of an attempt by the tenants in common to partition the property into separately owned parcels. *See, e.g., Standard & Poor's U.S. CMBS Legal and Structured Finance Criteria* p. 17 (2003). Some lenders' loan documents require a complete or partial waiver of the right of partition. An agreement never to partition a property is unenforceable under Washington law. *Schultheis v. Schultheis*, 36 Wash. App. 588, 590, 675 P.2d 634 (1984). However, an agreement to "limit the right to partition for a reasonable or specific amount of time" is enforceable. *Id.* Further, if the parties agree never to partition a property, rather than finding the agreement void, a court should determine a reasonable term for the agreement and enforce it for that period. *Id.* at 591.

Washington's partition statute is RCW chapter 7.52, which has not been amended since territorial times. Generally, there is a preference for the property to be physically partitioned in kind rather than for it to be sold and the proceeds divided unless a physical partition in kind "cannot be made without great prejudice to the owners." RCW 7.52.080.

Among the features of Washington partition law that may be of interest to lenders are the following:

1. The costs of the partition action can take priority over preexisting liens on the property. RCW 7.52.030 and .220.
2. When there is a lien on the interest of fewer than all the tenants in common, after partition that lien will attach only to the share of the property allocated to the tenants in common whose interest in the property was encumbered by the lien. RCW 7.52.030.
3. There is a marshaling provision, which allows the court: (a) to require the holder of a lien on the property to be partitioned, or any part of that property, to first exhaust its other collateral before a distribution of the proceeds of the partition; or (b) to "order a just deduction to be made from the amount of the lien on the property on account [of the other collateral]." RCW 7.52.230.
4. Where the partition is by means of sale of the property, referees appointed by the court sell the property by public auction "in the manner required for the sale of real property on execution." RCW 7.52.270. There is a procedure for a lienholder to credit bid its debt at a partition sale. RCW 7.52.390. The referees are allowed to sell the property on credit and take security for the unpaid portion of the purchase price in the names of the parties entitled to share in the proceeds of the partition. RCW 7.52.290 and .420.

U. Multiple Mortgagees

Where a deed of trust or mortgage secures multiple promissory notes held by different parties, the holders of the notes are entitled to share *pro rata* in the proceeds of the mortgaged

property in the absence of an agreement among them to the contrary. *Robbins v. Wilson Creek State Bank*, 5 Wash. 2d 584, 595-96, 105 P.2d 1107 (1940). When one of the holders realizes on the common collateral, that holder takes the collateral or its proceeds in trust for the other holders. *Id.*

V. Real Estate Collateral in Multiple States

It is common in commercial financings for mortgages or deeds of trust on properties in more than one state to secure a single debt. Washington has very little law on such arrangements, although an early case allowed judicial foreclosure of a Washington mortgage after the creditor foreclosed a California mortgage securing the same debt and obtained a deficiency judgment from the California court. *Widmann v. Hammack*, 110 Wash. 77, 187 Pac. 1091 (1920). In such situations, the lender must carefully consider the laws of all the relevant states, especially any applicable one-action and antideficiency laws, in order to structure a realization strategy that maximizes its recovery on the debt and avoids foreclosing on part of its collateral in a way that could bar it from later realizing on other collateral.

Where properties in multiple states secure a single debt, a question may arise as to whether Washington's one-action rules (RCW 61.24.030(4) and RCW 61.12.120) preclude simultaneous prosecution of foreclosure actions in Washington and one or more other states.

The nonjudicial foreclosure statute expressly permits foreclosure of other liens securing the same debt during or after a nonjudicial foreclosure on a Washington property. RCW 61.24.030(4) and .100(3)(b).

One treatise, in discussing RCW 61.12.120, the judicial foreclosure statute, states: "Statutes of this sort arguably should be interpreted to prohibit only the concurrent prosecution of a foreclosure action and an action for a judgment on the debt, rather than barring the simultaneous prosecution of foreclosure actions, particularly those in different states." 2 Madison, Dwyer and Bender, *The Law of Real Estate Financing* § 12:102 fn.8 (rev. ed. 2008). That treatise goes on to state:

. . . there is authority requiring that mortgagees include all the mortgaged property in the same foreclosure action or be held to have waived the mortgage lien on the remaining property. *See, e.g., Dooly v. Eastman*, 28 Wash. 564, 68 P. 1039 (1902). These cases tend to stem from one-action rule jurisdictions and in any event may be distinguishable where the mortgaged property is located in other states, as opposed to the same jurisdiction, and therefore unsuited for resolution in a single judicial foreclosure action.

Id. at fn.9. *See also Tacoma Savings Bank & Trust Company v. Safety Investment Company*, 123 Wash. 481, 212 Pac 726 (1923) (distinguishing *Dooly v. Eastman* and allowing two separate mortgages securing a common debt to be foreclosed separately).

W. Dragnet Clauses

Washington has little law on the enforceability of dragnet clauses (*i.e.*, a clause in a deed of trust or mortgage providing that all past, present and future debts owing to the secured creditor are secured by the security instrument). In *Carey v. Herrick*, 146 Wash. 283, 263 Pac. 190 (1928), the Washington Supreme Court enforced a dragnet clause. Although that case was decided under Idaho law, the court did not look to binding Idaho precedent in reaching its conclusion, but instead relied on general law to enforce the clause. *Id.* at 146 Wash. 297. Therefore, it could be expected that the court would have reached the same result had the case been decided under Washington law.

In order to avoid an argument that a dragnet clause is enforceable, it is advisable that a lender describe the types of obligations intended to be covered by it as specifically as possible. For example, the clause could state that it is intended to extend to the types of debts that courts in other states have often held not to have been intended to be included within the meaning of short, broadly-worded dragnet clauses. These might include, for example: (a) specific existing obligations intended to be secured; (b) obligations that are different in type or character from those specifically identified; (c) obligations that are separately secured; (d) obligations incurred by way of guaranty or suretyship; (e) obligations on which the debtor is obligated with other parties; (f) obligations that do not refer to the security instrument; and (g) obligations originally owed to third parties and later acquired by the secured creditor. *See generally* Nelson and Whitman, *Real Estate Finance Law* § 12.8 (5th ed. 2007). However, as discussed in greater detail in Section VI.D.2.b(ii) of this guide, an overly broad dragnet clause in a deed of trust can create problems for the lender under Washington's anti-deficiency laws.

Where the collateral is personal property rather than real estate, Article 9 of the Uniform Commercial Code broadly authorizes dragnet clauses. See RCW 62A.9A-204(c) and official comment 5 thereto.

VII. PERSONAL PROPERTY LENDING

A. UCC Revised Article 9

Washington adopted Revised Article 9 of the Uniform Commercial Code ("UCC") with the uniform effective date of July 1, 2001. It is codified at RCW chapter 62A.9A.

The Washington comments to Revised Article 9 prepared by the Washington State Bar Association's Uniform Commercial Code Committee contain a section-by-section description of areas in which Revised Article 9 as adopted in Washington differs from the official text of Revised Article 9. Those comments (which do not discuss all the variations) are available at www.wsba.org/lawyers/groups/businesslaw/businesslaw2000ucc.htm. Washington omitted a number of the consumer protection provisions contained in the official text. Some of the other variations that are relevant to commercial lenders are:

1. Transfers by the State of Washington and its political subdivisions are excluded from the coverage of Article 9. RCW 62A.9A-109(d)(14).

2. The official version of RCW 62A.9A-309(2) provides for automatic perfection without filing of assignments of accounts or payment intangibles which do not constitute a “significant” part of the assignor’s accounts or payment intangibles. The Washington version sets an objective threshold of \$50,000 or ten percent of the assignor’s total outstanding accounts or payment intangibles.

3. RCW 62A.9A-333(b) provides that: “A possessory lien on goods has priority over a security interest in the goods only if the lien is created by a statute that expressly so provides.” The official text has the opposite rule – the possessory lien has priority unless it is created by a statute that provides otherwise.

4. RCW 62A.9A-406(f) and (j) of the official text have been omitted so as to preserve existing Washington statutes that expressly prohibit, or require governmental approval for, transfers of accounts or chattel paper (*e.g.*, RCW 67.70.100, which requires court approval to assign lottery winnings).

5. RCW 62A.9A-602 and -624 vary from the official text in that they except secondary obligors from certain prohibitions on waivers of rights under certain provisions of Article 9.

6. Washington omits subsection 9-615(f) of the official text, an upset price procedure, which would allow a debtor to challenge the sufficiency of the sale price obtained in a private foreclosure sale at which the purchaser was the secured party or its affiliate or a guarantor, even though the secured party proves that the sale was commercially reasonable.

B. Security Interests Excluded From Article 9

1. Insurance Policies

Washington has adopted Revised Article 9’s provision excluding transfers of interests in or claims under insurance policies from the coverage of Article 9 (with the usual exception of certain assignments of health-care insurance receivables). RCW 62A.9-109(d)(8).

The law regarding assignments for security purposes of interests in or claims under policies of insurance that are not covered by Article 9 is not well-developed in Washington; however, Washington statutory and decisional law generally recognizes the validity and enforceability of written assignments for security purposes of such interests or claims under policies of life insurance. *See* RCW 48.18.360; *Massachusetts Mutual Life Insurance Company v. Bank of California, N.A.*, 187 Wash. 565, 570, 60 P.2d 675 (1936); *Seattle Association of Credit Men v. Bank of California, National Association*, 177 Wash. 130, 138-39, 30 P.2d 972 (1934).

It is advisable in taking a security interest in an insurance policy or its proceeds to observe the following procedure to the extent feasible: (a) review and comply with any assignment provisions set forth in the policy; (b) have the owner of the policy and each beneficiary sign an appropriate form of security, assignment and pledge agreement; (c) obtain the written acknowledgment of the insurer to the grant of the security interest, agreement to pay the proceeds of the policy to the secured party, and acknowledgment that it is not aware of any prior

assignments of the policy or its proceeds (many insurers have their own forms, which they insist on using); and (d) take possession of the original policy.

2. Titled Vehicles (Including Manufactured Homes)

Washington's certificate of title laws are contained in RCW chapter 46.12 (relating to motor vehicles) and RCW chapter 88.02 (relating to boats). The specific provisions of those statutes governing perfection of security interests in titled goods by notation on the certificate of title are RCW 46.12.095 and .103 and RCW 88.02.070. A security interest in titled vehicles held for sale or lease in the inventory of a dealer or lessor is perfected by filing a financing statement rather than by notation on the certificate of title. RCW 62A.9A-311(d).

Trailers used on public roads are subject to certificate of title laws, but heavy equipment not operated on roads is typically not titled. Manufactured homes are titled vehicles even though they are of a design such that they are intended to be permanently attached to real estate. Once they are so attached, the title may be "eliminated" pursuant to RCW chapter 65.20 and thereafter, a lien can be taken on them only by means appropriate to taking a lien on other real property. A real estate lender can insure that title elimination has occurred and the home has been incorporated into the real property by obtaining an ALTA form 7 endorsement to its lender's title insurance policy. Until title is so eliminated, the manufactured home "is not...real property in any form, including fixture law." RCW 65.20.030. The definition of "manufactured home" used in the uniform version of Revised Article 9 Section 9-102(53) has been replaced in Washington by a reference to the definition of "mobile home" or "manufactured home" contained in RCW 46.04.302. *See* RCW 62A.9A-102(53).

Federally-documented vessels are not subject to state certificate of title laws. RCW 88.02.070(2).

3. Property of Governmental Entities

Transfers by the State of Washington or a governmental unit of the state are excluded from Article 9 of the UCC by a nonuniform provision. RCW 62A.9A-109(d)(14).

4. Judgments

Washington has little law on the subject of the assignment of judgments for security purposes. Such assignments are excluded from the coverage of Article 9 of the UCC by RCW 62A.9A-109(d)(9). There is a statute providing that any assignment of a judgment must be acknowledged and must be filed with the clerk of the county where the judgment is recorded. RCW 4.56.090. In order to provide the maximum possible notice, a party taking a security interest in a judgment should follow the requirements of that statute, file a financing statement with the Department of Licensing and, if the judgment affects title to real property, record the assignment in the real property records. While the financing statement is not effective to perfect the security interest under Article 9, it does provide additional public notice.

C. Priority Versus Statutory Lienholders

Washington law provides for a number of statutory liens. These include, by way of example, landlords' liens, mechanics' and material suppliers' liens, crop liens, timber liens, attorneys' liens, real estate brokers' liens, liens for transportation and storage, and liens on dies, forms, molds and patterns. Many, but not all, such liens are provided for in RCW title 60.

As noted above, Washington's variation of UCC Revised Article 9 Section 333(b) provides that certain possessory statutory liens securing "an obligation for services or materials furnished with respect to goods" are senior in priority to Article 9 security interests only if the statute creating the lien expressly so provides. The priority of nonpossessory statutory liens other than judgment liens and agricultural liens is not addressed in Article 9.

Landlords' liens on a tenant's personal property located at the leased premises are provided for in RCW 60.72. Generally, they secure a maximum of two months' rent. RCW 60.72.010. They have priority as of the effective date of the lease. *Paris American Corporation v. McCausland*, 52 Wash. App. 434, 439, 759 P.2d 1210 (1988). Landlords' liens are strictly construed against the landlord. *Id.* RCW 62A.9-109(d)(1) provides that UCC Revised Article 9 does not apply to landlords' liens other than agricultural liens.

RCW 60.24 provides liens on timber and related products in favor of various parties involved in the timber and lumber industries. Those liens are prior to UCC security interests and various other liens pursuant to RCW 60.24.038 and *In re Brazier Forest Products, Inc.*, 106 Wash. 2d 588, 724 P.2d 970 (1986). They are particularly troublesome liens for holders of security interests in timber because they do not require possession by the lienholder and they are filed at the county level.

A discussion of agricultural liens under Washington law is beyond the scope of this guide; however, a detailed treatment of the subject is provided in Section 7.7 of Kaplan, *et al.*, *Washington Secured Transactions Under Revised Article 9 of the Uniform Commercial Code* (2005 ed.). Washington statutes provide for various liens related to farming activities. *See, e.g.*, RCW 15.08.090 (lien for disinfection of horticultural products), RCW 15.44.090 (lien of state dairy products commission), RCW 16.04.060 (lien on trespassing animals), RCW 16.57.223 (lien for livestock branding inspection), RCW 22.09.371 (depositor liens), RCW 60.11 (crop liens), RCW 60.13 (processor and preparer liens), RCW 60.16 (labor liens on orchards and orchard lands), RCW 60.52 (liens for services of sires) and RCW 60.56 (agister and trainer liens). However, not all of those liens qualify as "agricultural liens" as that term is used in Article 9 of the Uniform Commercial Code. RCW 62A.9A-102(5).

There is a lien to secure Washington's personal property tax. RCW 84.60.010. It takes priority over all Article 9 liens on the property taxed. *Id.*

Washington's retail sales tax, which is collected by the seller, is a trust fund tax. RCW 82.08.050. Therefore, an Article 9 security interest in a borrower's accounts receivable does not attach to the portion of the account that represents the sales tax and asset-based lenders should be careful to exclude sales taxes from the class of eligible receivables against which they will make advances.

Pursuant to RCW 60.68.015, federal tax liens and other federal liens are to be filed in the appropriate county real estate records as to real property and with the Washington Department of Licensing as to personal property. Although perfected security interests in a bank account can take priority over a federal tax lien, the federal tax lien has priority over the depository bank's unexercised right of setoff. *Peoples National Bank of Washington v. United States*, 777 F.2d 459 (1985).

D. UCC Filing and Searching

UCC-1 financing statements are filed with the Uniform Commercial Code Division of the Washington Department of Licensing (with the usual exceptions for fixture filings, timber to be cut and filings relating to as-extracted collateral, each of which are filed at the county level). RCW 62A.9A-501. Detailed information about filing requirements, fees, etc. is available on the Department of Licensing's website at www.dol.wa.gov.

The Washington Supreme Court has upheld a contractual limitation of liability in a UCC lien search service provider's contract limiting its liability for a defective search to the search fee charged to its customer even where the customer relied on the defective search and made a loan secured by collateral subject to a prior lien that was not shown in the search report. *Puget Sound Financial, L.L.C. v. Unisearch, Inc.*, 146 Wash. 2d 428, 47 P.3d 540 (2002). In that case, the court upheld a clause in the search firm's invoices limiting its liability to the \$25 search fee.

E. Taxation of Foreclosure Sales

For information about Washington taxes that may be applicable to Article 9 foreclosure sales, see Section III.C above.

F. Miscellaneous

Several Washington cases on personal property lending issues are worthy of note.

Security Interest in Partnership Voting and Management Rights. *Casey v. Chapman*, 123 Wash. App. 670, 98 P.3d 1246 (2004) indicates that a creditor intending to take a security interest in a partnership interest that will allow the purchaser of that interest in an Article 9 sale to have the debtor's voting and management rights in the partnership (rather than just the interest in partnership profits) must be extremely careful and thorough in making that clear in the security documents and in obtaining the consent of the other partners even if the secured creditor is also a partner or former partner in the partnership.

After-Acquired Property. The court in *Paulman v. Gateway Venture Partners III, L.P.*, 163 F.3d 570, 578 (9th Cir. 1998) held that, under Washington law, a security interest in "inventory" and "accounts receivable" presumptively includes after-acquired property even if the documents do not expressly so provide, subject to rebuttal by evidence that the parties intended otherwise. It based its decision on the fact that these types of collateral are constantly turning over and no creditor could reasonably agree to be secured only by the debtor's current inventory and accounts. *Id.* at 579.

Commercially Reasonable Time for Sale of Collateral. One Washington court found that a secured party that waited eight months from repossession of a piece of farm equipment to sell the collateral failed to prove that the delay was commercially reasonable and, on that basis, denied the creditor a deficiency judgment. *Empire South, Inc. v. Repp*, 51 Wash. App. 868, 756 P.2d 745 (1988). It did so even though the delay was over the winter and the debtors at one point requested a 30-day delay in the sale. *Id.* at 51 Wash. App. 872. The case highlights the need for a foreclosing secured creditor to be able to prove the commercial reasonableness of its sale of collateral.

VIII. EQUIPMENT LEASING

Washington has adopted Article 2A of the UCC. RCW chapter 62A.2A. The Washington variations from the uniform text are collected in the state variations volume of the *Uniform Commercial Code Reporting Service*.

There are specific statutes governing consumer leases (RCW 63.10) and lease purchase agreements (RCW 63.19).

IX. GUARANTIES AND SURETYSHIP

A. Waivers of Suretyship Defenses

Waivers of suretyship defenses in guaranties are generally enforced in Washington. *See, e.g., Warren v. Washington Trust Bank*, 92 Wash. 2d 381, 598 P.2d 701 (1979); *Fruehauf Trailer Company of Canada Limited v. Chandler*, 67 Wash. 2d 704, 409 P.2d 651 (1966); *Franco v. Peoples National Bank of Washington*, 39 Wash. App. 381, 693 P.2d 200 (1984). Without such a waiver, guarantors and other sureties have a wide range of defenses, as is the case in all states.

B. Guaranties

A guaranty must be supported by consideration, although there need not be independent consideration flowing to the guarantor and the consideration to the principal obligor is sufficient consideration for the guaranty. *Union Bank v. Kruger*, 1 Wash. App. 622, 463 P.2d 273 (1969). However, the consideration must be contemporaneous with or subsequent to the execution and delivery of the guaranty. *Cowles Publishing Company v. McMann*, 25 Wash. 2d 736, 172 P.2d 235 (1946). Washington cases have held guaranties to fail for lack of consideration. *See, e.g., Universal C.I.T. Credit Corporation v. DeLisle*, 47 Wash. 2d 318, 287 P.2d 302 (1955).

Pursuant to RCW 23B.03.020(2)(h), unless the articles of incorporation expressly provide otherwise, a Washington corporation has the power to make guaranties of the obligations of others if the guaranty “may reasonably be expected to benefit, directly or indirectly, the guarantor corporation.” The statute also provides that “the decision of the board of directors that the guaranty may reasonably be expected to benefit, directly or indirectly, the guarantor corporation shall be binding in respect to the issue of benefit to the guarantor corporation.” Washington law does not contain such specific provisions regarding guaranties by other types of entities.

Where a guarantor guarantees only a limited portion of the principal obligor's debt, unless the guaranty specifies the rate of interest applicable to the guarantor's obligation, it will bear interest at the legal rate rather than at the rate borne by the guaranteed promissory note or other obligation. *Seattle-First National Bank v. West Coast Rubber, Inc.*, 41 Wash. App. 604, 608-09, 705 P.2d 800 (1985).

Where a borrower owes multiple debts to a lender, one of which is guaranteed, the lender generally is not obligated to apply payments made by the borrower first to the guaranteed debt, although there are some exceptions to that rule. *Warren v. Washington Trust Bank*, 92 Wash. 2d 381, 598 P.2d 701 (1979).

A continuing guaranty is revoked as to subsequent advances by notice of the death of the guarantor, unless there is an express provision to the contrary. *Exchange National Bank of Spokane v. Hunt*, 75 Wash. 513, 516, 135 Pac. 224 (1913).

C. Other Suretyship Situations

A party agreeing to be liable for a loan, but that does not actually receive the loan proceeds or otherwise receive the direct benefit of the loan, should sign a guaranty rather than simply signing the promissory note as a purported primary obligor. Otherwise, such a party, even if that party receives an indirect benefit from the transaction, can be characterized as an accommodation party or surety and may be allowed to take advantage of various suretyship defenses, which are not typically waived in promissory notes. *See Plein v. Lackey*, 149 Wash. 2d 214, 67 P.3d 1061 (2003). *See also* Uniform Commercial Code § 3-419 and 3-605 (RCW 62A.3-419 and 3-605). Alternatively, if the note is secured by a deed of trust, if such a party signs the note rather than a guaranty, it may argue that it is a borrower rather than a guarantor and is therefore not subject to a deficiency judgment after a nonjudicial foreclosure pursuant to RCW 61.24.100.

Where a third party assumes the borrower's obligations on a loan, the creditor has "definite and specific notice" of the assumption, and the creditor consents to the assumption, the original debtor may become merely a surety for the debt with the panoply of defenses generally available to sureties. *Hemenway v. Miller*, 116 Wash. 2d 725, 728-29, 807 P.2d 863 (1991).⁸ Such assumptions usually occur in connection with a transfer of the collateral for a loan. In *Hemenway*, the buyer of a business executed a promissory note to the seller for a portion of the purchase price. The note was secured by assets of the business. The buyer later sold the business and the collateral to a third party, who assumed liability on the note. When the second buyer defaulted on the loan, the original buyer defended against the original seller's claim on the note on the basis that the original seller had allowed the perfection of its security interest to lapse and had thereby unjustifiably impaired the collateral giving the original buyer a defense to payment of the note under UCC § 3-606. The lesson of the *Hemenway* case is that, when a lender becomes aware that its collateral has been transferred in violation of the provisions of the loan documents, it should either proceed to enforce its remedies for default immediately or enter into an assumption agreement under which the original borrower agrees to remain fully,

⁸ Some older cases do not seem to require the consent of the creditor in order for the original primary obligor to become a mere surety. *See e.g. Gillman v. Purdy*, 167 Wash. 659, 9 P.2d 1092 (1932).

unconditionally and primarily liable for the loan and waives all suretyship defenses that might otherwise be available to it. Such waivers are enforceable under the principles discussed in Section IX.A above. *See, e.g., Century 21 Products, Inc. v. Glacier Sales*, 129 Wash. 2d 406, 413, 918 P.2d 168 (1996). As a result, it is not entitled to be subrogated to the rights of the creditor if its interest in the property is foreclosed out. *Id.* at 222. However, it should be possible to obtain equivalent rights by contract at the time the loan is entered into.

D. Reimbursement, Subrogation and Contribution Rights

A guarantor who pays a guaranteed obligation is entitled to reimbursement by the borrower and is entitled to be subrogated to the rights of the lender against the borrower, including its collateral. *McAllister v. Pier 67, Inc.*, 1 Wash. App. 978, 985-86, 465 P.2d 678 (1970). *See also National Bank of Washington v. Equity Investors*, 86 Wash. 2d 545, 556, 546 P.2d 440 (1976). Similar concepts apply in other types of suretyship situations. *See generally Reliance Insurance Co. v. U.S. Bank of Washington, N.A.*, 143 F.3d 502 (9th Cir. 1998) (applying Washington law).

Absent an effective waiver of that defense in the guaranty, if the lender releases collateral of the borrower for the guaranteed debt, the guarantor's liability on the guaranty may be discharged. *See Warren v. Washington Trust Bank*, 92 Wash. 2d 381, 390, 597 P.2d 1353 (1979).

Where multiple owners of a corporation or other entity guarantee the entity's debt, they should seriously consider entering into a contribution agreement providing for how they will share the liability on the guaranty among themselves if they are called upon to pay it. In the absence of such an agreement, the guarantors are liable for contribution among themselves on an equal per capita basis and not pro rata according to their ownership interests in the entity. *Brill v. Swanson*, 36 Wash. App. 396, 674 P.2d 211 (1984); *Brooke v. Boyd*, 80 Wash. 213, 141 Pac. 357 (1914). That is often not the result the guarantors would expect or want. Such contribution agreements should also address the mechanics of enforcement of contribution obligations, the effect of the insolvency of one or more of the guarantors, the rate of interest on contribution obligations and whether the guarantor enforcing the contribution obligations is entitled to recover attorneys' fees and other costs. Absent such an agreement, the guarantor seeking contribution is entitled to interest at the legal rate and is not entitled to recover attorneys' fees and costs. *Appleford v. Snake River Mining, Milling & Smelting Company*, 122 Wash. 11, 210 Pac. 26 (1922).

X. RECEIVERSHIP/ASSIGNMENT FOR BENEFIT OF CREDITORS

Washington's general receivership statute is set forth in RCW chapter 7.60. Appointment of a receiver is a common procedure in the case of defaults on real estate loans and is specifically contemplated by RCW 7.60.025. In 2004, Washington's legislature completely revised and greatly expanded the state's receivership statute. The revised statute has many features comparable to the federal bankruptcy law, including in some cases an automatic stay (RCW 7.60.110) and the power to sell receivership property free and clear of liens (RCW 7.60.260). Some of these provisions are arguably subject to challenge on the basis of federal preemption as were some earlier state insolvency statutes. *See, e.g., Armour Company v. Becker*, 167 Wash.

245, 252, 9 P.2d 63 (1932). A receiver under the state statute may have more latitude to sell assets free and clear of liens than is available to a trustee or debtor in possession under the federal bankruptcy law.

The statute provides both for general receivers, which take possession and control of all or substantially all of a person or entity's property, and custodial receivers, which take charge of limited property or are not given authority to liquidate property. RCW 7.60.015.

The court in *In re Sundance Corp.*, 149 B.R. 641 (Bankr. E.D. Wash. 1993), considered at length the liability of a court-appointed receiver for environmental contamination of property in the receiver's control under various common law and statutory theories.

The 2004 legislature also extensively revised Washington's little-used assignment for benefit of creditors statute, RCW chapter 7.08. Under that statute, an assignee for benefit of creditors is appointed as a receiver subject to the provisions of the receivership statute upon the filing of a petition with the superior court and the assignment does not become effective until that petition is filed. RCW 7.08.030(3).

XI. LENDING ON INDIAN LAND OR TO INDIAN TRIBES OR CORPORATIONS.

Lending on Indian land presents unique challenges under federal and tribal law. The bankruptcy court for the Eastern District of Washington addressed a number of the relevant issues (including the relationship of the Washington real estate recording system and the separate recording system maintained by the federal Bureau of Indian Affairs) in *In re Emerald Outdoor Advertising, L.L.C.*, 300 B.R. 775 (Bankr. E.D. Wash. 2003), *affirmed* 444 F.3d 1077 (9th Cir. 2006).

Indian Tribes and certain related entities generally have immunity from suit in state courts. In *Wright v. Colville Tribal Enterprise Corporation*, 159 Wash. 2d 108, 147 P.3d 1275 (2006), the Washington Supreme Court held that “[t]ribal sovereign immunity protects a tribal corporation owned by a tribe and created under its own laws, absent express waiver of immunity by the tribe or Congressional abrogation.” *Id.* at 111-112. This is true for tribal governmental corporations and their subsidiaries even when “conducting a commercial enterprise outside the reservation.” *Id.* at 114. However, “a tribe may waive the immunity of a tribal enterprise by incorporating the enterprise under state law, rather than tribal law.” *Id.* at 115.

XII. OTHER LAWS OF INTEREST

A. Recovery of Attorneys' Fees

Pursuant to RCW 4.84.330, provisions of loan documents, leases or other agreements requiring one party to pay the other party's attorneys' fees and costs to enforce the provisions thereof will be construed to entitle the prevailing party in any action, whether or not the party named in the document is the prevailing party, to be awarded its costs and reasonable attorneys' fees. Attorneys' fees and costs are awarded to the prevailing party even when the prevailing party succeeds in invalidating the contract containing the attorneys' fees provision unless the parties never intended to form a contract. *Compare Labriola v. Pollard Group, Inc.*, 152

Wash. 2d 828, 839, 100 P.3d 791 (2004) with *Wallace v. Kuehner*, 111 Wash. App. 809, 46 P.3d 823 (2002).

In an appropriate case, a party may be entitled to recover attorneys' fees for work performed by its salaried in-house counsel. *Metropolitan Mortgage & Securities Co., Inc. v. Becker*, 64 Wash. App. 626, 631-34, 825 P.2d 360 (1992).

B. Fraudulent Transfer Law

Washington has adopted the Uniform Fraudulent Transfer Act. It is codified at RCW chapter 19.40. In most, but not all cases, an action to avoid a fraudulent transfer must be brought within four years of the date the relevant transfer is made or obligation is incurred. RCW 19.40.091.

Even if a transfer of property is avoided as a fraudulent transfer, if the transferee obtained a bona fide loan from a good faith lender while in title to the property, the lien securing the loan will be preserved despite the avoidance of the borrower's title. *Associates Housing Finance v. Stredwick*, 120 Wash. App. 52, 83 P.3d 1032 (2004).

The enforcement of a security interest in compliance with Article 9 of the Uniform Commercial Code is not avoidable under the Washington fraudulent transfer statute in the absence of actual intent to hinder, delay or defraud a creditor. RCW 19.40.081(e). The same rule applies to proper termination of a lease upon default. *Id.* Similarly, the price paid for property at a regularly-conducted noncollusive tax foreclosure sale under Washington law is conclusively deemed to be "reasonably equivalent value" for purposes of the fraudulent transfer statute so that such a sale may not be invalidated under that statute. *In re Samaniego*, 224 B.R. 154 (Bankr. E.D. Wash. 1998).

C. Environmental Laws and Regulations

Washington has extensive laws and regulations governing environmental matters. These laws and regulations are administered and enforced by the Washington Department of Ecology ("DOE"). Washington has enacted the Model Toxics Control Act ("MTCA"), which is codified at RCW chapter 70.105D. Washington's version of MTCA contains various provisions intended to protect lenders secured by contaminated property from liability for the contamination. That is accomplished largely by excluding from the definition of "owner or operator" of a property a "person who, without participating in the management of a facility, holds indicia of ownership primarily to protect the person's security interest in the facility." RCW 70.105D.020(12)(b)(ii). The act provides that "[h]olding indicia of ownership after foreclosure or its equivalents for longer than five years shall be considered to be holding the indicia of ownership for purposes other than primarily to protect a security interest." RCW 70.105D.020(18). Therefore, if a lender forecloses on a contaminated property and is unable to sell it within five years, it may be subject to liability as an owner or operator of the property.

Prior to 2005, Washington's only statutory environmental lien on real property was a lien provided for by RCW 70.121.140, which relates to mining and milling of uranium and thorium. That lien "has priority over any lien, interest, or other encumbrance previously or thereafter

recorded or filed concerning any property described in the statement of claim, to the extent allowed by federal law.”

In 2005, the legislature enacted RCW 70.105D.055. It gives DOE the right to file a lien against certain real property in the state when DOE incurs environmental remediation costs for that property. The lien has super-priority over existing mortgage liens on the property in certain limited circumstances. Some salient features of the lien are:

1. It is generally junior to existing mortgage liens.
2. It can be elevated to a priority senior to that of existing mortgage liens where all of the following conditions are met:
 - (a) The property is “abandoned” within the meaning of the statute, which means that either (i) “there has not been significant business activity on the real property for three years” or (ii) property taxes on the property are three years in arrears.
 - (b) DOE limits the amount of its lien to the “increase in the fair market value of the real property that is attributable to a remedial action conducted by [DOE].”
 - (c) The property is not: (i) owned by a local government or special purpose district; or (ii) a 1-4 family residential property (unless it is an “illegal drug manufacturing and storage site”).
3. The increase in value is determined by subtracting the assessed value of the property for the most recent year prior to the initiation of the remedial action from either the bona fide purchase price of the property or the appraised value of the property determined by an appraiser retained by DOE.
4. Certain advance notices to the owner of the property and to lienholders are required.

D. Exclusion of Punitive Damages

Punitive damages are not available in Washington unless specifically authorized by statute. *Dailey v. North Coast Life Insurance Company*, 129 Wash. 2d 572, 573-74, 919 P.2d 589 (1996). A limited number of statutes provide for some form of enhanced damages, although they are generally limited in amount. *See, e.g.*, RCW 19.86.090 (triple damages for violation of Consumer Protection Act) and RCW 4.24.630, RCW 64.12.030 and RCW 79.02.340 (triple damages for unlawful cutting or removal of trees, crops, minerals, etc).

E. Statute of Frauds

Washington’s statute of frauds is found in RCW chapter 19.36. Two provisions are of particular interest to lenders.

1. Credit Agreements

RCW 19.36.110 contains a special statute of frauds applicable to “credit agreements”, which is intended to protect lenders against claims that there were oral agreements that modified the written loan documents. “Credit agreement” is defined to mean “an agreement, promise, or commitment to lend money, to otherwise extend credit, to forbear with respect to the repayment of any debt or the exercise of any remedy, to modify or amend the terms under which the creditor has lent money or otherwise extended credit, to release any guarantor or cosigner, or to make any other financial accommodation pertaining to a debt or other extension of credit.” RCW 19.36.100.

Where the statute applies, the lender has the benefit of RCW 19.36.110, which provides:

A credit agreement is not enforceable against the creditor unless the agreement is in writing and signed by the creditor. The rights and obligations of the parties to a credit agreement shall be determined solely from the written agreement, and any prior or contemporaneous oral agreements between the parties are superseded by, merged into, and may not vary the credit agreement. Partial performance of a credit agreement does not remove the agreement from the operation of this section.

In order to have the benefit of the statutory protections, the borrower must be given a statutorily-prescribed notice as follows:

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

The notice must “be in type that is bold face, capitalized, underlined, or otherwise set out from surrounding written materials so it is conspicuous.” RCW 19.36.140. For that reason, it is advisable that it be bolded, capitalized and underlined wherever it appears. The notice need not be put into every loan document in a transaction, but it must be given simultaneously with or before a credit agreement is made. RCW 19.36.130. Because the statute does not specify when a “credit agreement is made”, it is advisable to provide the notice in the earliest possible communication with the borrower and guarantors. Lenders in Washington commonly put the notice in all major loan documents and subsequent modifications.

Once the notice is given, it is “effective as to all subsequent credit agreements and effective against the debtor, and its guarantors, successors, and assigns.” RCW 19.36.130.

These provisions only apply to commercial loans. RCW 19.36.120.

If the lender does not properly invoke the protection of RCW chapter 19.36, the loan documents may be subjected to the general common law rule that “a contract clause prohibiting oral modifications is essentially unenforceable because the clause itself is subject to oral modifications.” *Pacific Northwest Group A v. Pizza Blends, Inc.*, 90 Wash. App. 273, 277-78, 951 P.2d 826 (1998).

2. Guaranties, Etc.

RCW 19.36.010(2) provides that “every special promise to answer for the debt” of another is void unless that promise “or some note or memorandum thereof, be in writing, and signed by the party to be charged therewith, or by some person thereunto by him lawfully authorized.” See *South Sound National Bank v. Meek*, 14 Wash. App. 577, 544 P.2d 25 (1975) for a summary of cases discussing the extent to which this statute applies to guaranties.

F. Statutes of Limitation

The statute of limitation applicable to promissory notes and other written contracts is six years. RCW 62A.3-118 and 4.16.040. For promissory notes that are payable on demand, the six-year period begins to run on the date of demand. RCW 62A.3-118(b). If no demand is made on such a note, an action to enforce the note is barred if neither principal nor interest has been paid for a continuous period of 10 years. *Id.* Prior to 1993, the statute of limitation on a demand note began to run immediately under former RCW 62A.3-122. A similar rule appears still to be effective for demand loans that are not evidenced by a note or other instrument subject to RCW 62A.3-118. See, e.g., *Wallace v. Kuehner*, 111 Wash. App. 809, 818-19, 46 P.3d 823 (2002) and cases cited therein.

The six-year statute also applies to actions on accounts receivable incurred in the ordinary course of business and to actions for the rents and profits, or for the use and occupation, of real estate. The statute of limitation applicable to oral contracts and most torts is three years. RCW 4.16.080. Some torts are subject to a two-year statute under RCW 4.16.130(3). As discussed in Section VI.O.2.b above, there is a one-year statute of limitations for actions seeking a deficiency after nonjudicial foreclosure of a deed of trust (in the limited situations where such an action is permitted). RCW 61.24.100.

If a lender fails to bring an action or foreclose on its security within the time permitted by the statute of limitations, the liens and security interests securing the debt are discharged. *Bingham v. Lechner*, 111 Wash. App. 118, 45 P.3d 562 (2002).

A borrower may raise an otherwise time-barred claim as an affirmative defense to a lender’s claim on a debt. *Seattle-First National Bank v. Siebol*, 64 Wash. App. 401, 407, 824 P.2d 1252 (1992).

G. Choice of Law Provisions

As a general rule, Washington courts will honor an express contractual choice of law provision agreed to by the parties to a contract and apply the substantive law of the chosen jurisdiction, unless: (1) Washington law would otherwise apply, the application of the law of the chosen jurisdiction would be contrary to a fundamental policy of the State of Washington, and Washington has a materially greater interest than the chosen jurisdiction in the determination of the particular issue; or (2) the chosen jurisdiction has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties’ choice. *McKee v. AT&T Corporation*, 164 Wash. 2d 372, 384, 191 P.3d 845 (2008).

Choice of law covenants apply only to substantive law and do not extend to procedural matters.

Washington has no statutory or case law specifically addressing the effect of bifurcated choice of law provisions where, for example, the loan agreement and promissory note are governed by New York law and the deed of trust on a Washington property is governed by Washington law. However, Washington courts often cite the *Restatement (Second) of Conflict of Laws* (1971) on conflict of laws issues (*see, e.g., McKee, supra*, at 164 Wash. 2d 383-85) and comment e to Section 229 of the Restatement contemplates that a mortgage instrument can be governed by different law than the underlying debt. The Restatement cites the early Washington case of *Mantle v. Dabney*, 47 Wash. 394, 92 Pac. 134 (1907) in that regard. *See also Maxwell v. Ricks*, 285 F. 656 (W.D. Wash. 1923), *aff'd* 294 F. 255 (9th Cir. 1923) (holder of note executed and delivered in California and secured by mortgage on California property allowed to waive collateral and sue on note in Washington federal court without following security-first doctrine of California law).

H. Forum and Venue Selection Provisions

Washington courts will generally enforce forum and venue selection clauses in contracts at least where they do not violate the public policy of the state, they are timely brought to the court's attention, all parties to the action are parties to the contract, and there is not "a good reason why the agreement should not be enforced." *Dix v. ICT Group, Inc.*, 160 Wash. 2d 826, 161 P.3d 1016 (2007); *Mangham v. Gold Seal Chinchillas, Inc.*, 69 Wash. 2d 37, 44-45, 416 P.2d 680 (1966). *See also* RCW 4.12.080.

I. Arbitration Agreements

Arbitration agreements are generally enforceable in Washington. The state has adopted the uniform arbitration act in RCW chapter 7.04A. Mandatory arbitration of certain relatively small monetary claims that are not subject to an arbitration agreement is provided for in RCW chapter 7.06. The courts have held that a class action waiver in an arbitration agreement is substantively unconscionable and unenforceable in certain situations where a class action offers the only effective avenue of relief (generally in the consumer context). *See, e.g., McKee v. AT&T Corporation*, 164 Wash. 2d 372, 396-98, 191 P.3d 845 (2008).

J. Jury Trial Waivers

Washington does not have any law specifically addressing the validity of contractual jury trial waivers. Washington law relating to jury trial waivers in other contexts is discussed in *Sackett v. Santilli*, 101 Wash. App. 128, 5 P.3d 11 (2000). *See* Section VI.O.3.d above for a discussion of the availability of a jury trial in a foreclosure action.

K. Duty of Good Faith; Deemed Insecurity Provisions

Washington law imposes a duty of good faith and fair dealing on the parties to all contracts, which "obligates the parties to cooperate with one another so that each may obtain the full benefit of performance." *Badgett v. Security State Bank*, 116 Wash. 2d 563, 569, 807 P.2d 356 (1991). However, that duty does not require a party to "accept a material change in the

terms of the contract” or “inject substantive terms into the parties’ contract.” *Id.* Therefore, a lender generally does not have an obligation to accept a workout or restructuring proposal from a borrower. *Badgett* also held that “a course of dealing does not over-ride express terms in a contract or add additional obligations.” *Id.* at 572. *But see, e.g., Sherman v. Lunsford*, 44 Wash. App. 858, 862-63, 723 P.2d 1176 (1986) (a waiver of contractual rights can occur through course of performance). In the same vein, Washington courts have held that “a history of providing financing does not create a duty to provide future financing.” *Seattle-First National Bank v. Westwood Lumber, Inc.*, 65 Wash. App. 811, 823, 829 P.2d 1152 (1992). The duty of good faith and fair dealing applies only where the parties have an existing contract between themselves. *Keystone Land & Development Company v. Xerox Corporation*, 152 Wash. 2d 171, 177, 94 P.3d 945 (2004). Washington law does not recognize or enforce an agreement to agree or impose an obligation of good faith in connection with such an agreement. *Id.* at 176.

RCW 62A.1-208 (Washington’s version of Uniform Commercial Code § 1-208) addresses contract provisions to the effect that a party can accelerate a debt or take other action if it deems itself insecure. Under that statute: “A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral ‘at will’ or ‘when he deems himself insecure’ or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired.”

L. Powers of Attorney

Washington has adopted the Uniform Durable Power of Attorney Act (but with substantial variations from the uniform text) at RCW chapter 11.94. Powers of attorney granted between spouses are addressed in RCW 26.16.060-.090. A general power of attorney does not permit the attorney-in-fact to make gifts of the principal’s property unless it expressly contains such authority. *Bryant v. Bryant*, 125 Wash. 2d 113, 119, 882 P.2d 169 (1994). In this regard, note the discussion in Section V.D.1. of this guide regarding the danger of a guaranty being construed as a gift.

When a lender accepts a signature under a power of attorney, it should obtain an affidavit complying with RCW 11.94.020(2) from the attorney-in-fact certifying that the power of attorney has not been revoked or terminated.

A power of attorney that has been recorded cannot be revoked by any act of the party by whom it was executed unless the instrument of revocation is also recorded in the same recording office. RCW 65.08.130. *Lazov v. Black*, 88 Wash. 2d 883, 567 P.2d 233 (1977).

M. Unauthorized Practice of Law

The selection and preparation of promissory notes and other loan documents constitutes the practice of law in Washington. *Washington State Bar Association v. Great Western Union Federal Savings and Loan Association*, 91 Wash. 2d 48, 55, 586 P.2d 870 (1978). Notwithstanding that rule, “whether or not a fee is charged, lenders are authorized to prepare the types of legal documents that are ordinarily incident to their financing activities when lay employees participating in such document preparation do not exercise any legal discretion.”

Perkins v. CTX Mortgage Company, 137 Wash. 2d 93, 106, 969 P.2d 93 (1999). However, “lenders must comply with the standard of care of a practicing attorney when preparing such documents.” *Id.*

Washington has a class of non-lawyer “limited practice officers”, who are authorized to “select, prepare and complete legal documents incident to the closing of real estate and personal property transactions.” Washington Admission to Practice Rule (“APR”) 12. Limited practice officers are required to pass a qualifying examination, fulfill continuing education requirements and meet certain other requirements. *Id.* They are permitted to select, prepare and complete a limited range of documents using standard forms approved by the state Limited Practice Board. APR 12(d); *Bishop v. Jefferson Title Company*, 107 Wash. App. 833, 842, 28 P.3d 802 (2001).

N. Subordination Agreements

In Washington, subordination agreements are generally enforceable in accordance with their terms and the courts have even enforced oral subordination agreements. *See Skeel v Christenson*, 17 Wash. 649, 50 Pac. 466 (1897). Also, if multiple, simultaneous instruments contain adequate statements about the intended order of priority among them, that ordering can be enforced. *See Bank of Gresham v. Johnson*, 143 Wash. 24, 254 Pac. 464 (1927).

As discussed in greater detail in Section VI.H.1 of this guide, due to the effect of Washington’s “race notice” recording system, a lender should not rely on recording order alone to establish the priority of a deed of trust or mortgage over another instrument recorded at substantially the same time, but should require an appropriate subordination agreement or other recorded acknowledgment of priority from the holder of the intended junior lien or interest.

At least where the subordinated creditor is the seller of the common collateral, a subordination agreement will be construed in favor of the subordinated creditor and the senior creditor’s “priority rights under a subordination agreement are strictly limited to the express terms and conditions of the agreement.” *Campanella v. Rainier National Bank*, 26 Wash. App. 418, 420, 612 P.2d 460 (1980); *Ban-Co Investment Co. v. Loveless*, 22 Wash. App. 122, 134, 587 P.2d 567 (1978). However, Washington courts have sometimes been willing to enforce agreements by sellers to subordinate to future financing obtained by the buyer even where the agreement contains no material detail about the terms of the future financing. *See White & Bollard, Inc. v. Goodenow*, 58 Wash. 2d 180, 185, 361 P.2d 571 (1961).

O. Marshaling of Collateral

Washington recognizes the equitable doctrine of marshaling under which a secured creditor having two items of collateral, one of which is subject to a junior lien and one of which is not, can be required to realize first on the collateral that is not subject to a junior lien. *In re Brazier Forest Products, Inc.*, 921 F.2d 221, 223 (9th Cir. 1990). Only a secured or lien creditor has standing to seek marshaling. *Wenatchee Production Credit Association v. Pacific Fruit and Produce Co.*, 199 Wash. 651, 659, 92 P.2d 883 (1939). Whether marshaling is granted rests largely in the discretion of the court and it is appropriate only if other creditors will not be harmed. *Edward L. Eyre & Co. v. Hirsch*, 36 Wash. 2d 439, 457, 218 P.2d 888 (1950).

As discussed in greater detail in Section VI.T of this guide, Washington's partition statute includes a marshaling provision. RCW 7.52.230.

Where multiple encumbered properties have been sold by the original mortgagor, a related equitable doctrine can be applied to require the secured creditor to realize on the properties in the "inverse order of alienation" (*i.e.*, by foreclosing first on the last property transferred by the original mortgagor, etc.). *Haueter v. Rancich*, 39 Wash. App. 328, 331, 693 P.2d 168 (1984).

P. Loan Commitments

Washington courts will not grant specific performance of a promise to lend money. *Eugster v. City of Spokane*, 118 Wash. App. 383, 76 P.3d 741 (2003).

As noted in Section XII.E.1 above, loan commitments should always contain the statute of frauds legend described in that Section.

Q. Confession of Judgment

Washington has a statute authorizing confession of judgment either with or without the prior filing of a lawsuit. RCW chapter 4.60. Washington lenders do not require confessions of judgment in loan documents as is common in some of the eastern states.

R. Insider Loans

Lenders should be wary in making loans to entities that are affiliates of the lender, especially if the borrower is in financial difficulty at the time of the loan. When an entity becomes insolvent, third party creditors often look for ways to be paid ahead of insider creditors and may assert that the insider debt should be subordinated to debts to third party creditors or should be recharacterized as a capital contribution to the entity. Washington does not have extensive law on this subject.

In some older cases, Washington courts have upheld secured loans made to a corporation even though the loans were by its stockholders or directors and even though the loans were made while the corporation was insolvent. *See Belcher v. Webb*, 176 Wash. 446, 449, 29 P.2d 702 (1934) (stating that such loans "will be subjected to the most rigid scrutiny by the courts"); *Terhune v. Weise*, 132 Wash. 208, 214, 231 Pac. 954 (1925) (citing authority that the insider loan must be made "honestly and in good faith" and is "subject to severe scrutiny by the courts"). In the more recent case of *Block v. Olympic Health Spa, Inc.*, 24 Wash. App. 938, 948, 604 P.2d 1317 (1979), the state's intermediate appellate court expressed doubt that such loans are proper while the entity is insolvent, but did so without referring to the earlier Supreme Court cases discussed above.

When a corporate officer or director makes a loan to the corporation, the burden of proving good faith is on the officer or director because of his or her fiduciary capacity. *Saviano v. Westport Amusements, Inc.*, 144 Wash. App. 72, 79, 780 P.3d 874 (2008).

The position of the insider creditor is more tenuous if it documents the loan long after the funds are advanced or takes collateral for its debt after the time it extends credit. *See Saviano v. Westport Amusements, Inc., supra; Terhune v. Weise, supra*, at 132 Wash. 215-217.

Certain provisions of the fraudulent transfer statute are applied more stringently with respect to insider creditors than noninsiders. *See, e.g.*, RCW 19.40.041 (b)(1) and 19.40.051(b).

In addition to possible attacks under state law, insider creditors should consider the possibility of their loans being equitably subordinated to debts to unaffiliated creditors under federal bankruptcy law. *See Stoumbos v. Kilimnik*, 988 F.2d 949, 958-61 (1993), for a case appealed from a federal district court sitting in Washington in which an insider debt was equitably subordinated on that basis.

S. Enforcement of Foreign Judgments

1. Judgments From Other States

Under Washington's version of the Uniform Enforcement of Foreign Judgments Act, RCW chapter 6.36, a judgment, decree or order of a court of the United States or of any sister state that is entitled to full faith and credit under the United States Constitution may be filed in any superior court of any county in Washington and, in some cases, may be filed in the district court of any county. RCW 6.36.025. The clerk of court is required to treat the foreign judgment in the same manner as a judgment of the Washington court in which it is filed. *Id.* A judgment so filed is subject to the same procedures, defenses, set-offs, counterclaims, cross-complaints, and proceedings for reopening, vacating, or stay as a judgment of a superior court in Washington and may be enforced or satisfied in the same manner as a Washington judgment. *Id.*

2. Judgments From Foreign Countries

Washington has adopted the Uniform Foreign Money-Judgment Recognition Act at RCW chapter 6.40. Under that act, a judgment of court of competent jurisdiction that is final and conclusive and enforceable in a foreign country (even though an appeal therefrom is pending or it is subject to appeal) is conclusive between the parties and is enforceable in Washington in the same manner as the judgment of a sister state that is entitled to full faith and credit under the United States Constitution to the extent that it grants or denies recovery of a sum of money, except that: (a) a foreign judgment is not conclusive if (i) the judgment was rendered under a system that does not provide impartial tribunals or procedures compatible with the requirements of due process of law, (ii) the foreign court did not have personal jurisdiction over the defendant, or (iii) the foreign court did not have jurisdiction over the subject matter; and (b) a foreign judgment need not be recognized if (i) the defendant in the proceedings in the foreign court did not receive notice of the proceedings in sufficient time to enable the defendant to defend, (ii) the judgment was obtained by fraud; (iii) the claim for relief on which the judgment is based is repugnant to the public policy of the State of Washington, (iv) the judgment conflicts with another final and conclusive judgment, (v) the proceeding in the foreign court was contrary to an agreement between the parties under which the dispute in question was to be settled otherwise than by proceedings in that court, or (vi) in the case of jurisdiction based only on personal

service, the foreign court was a seriously inconvenient forum for the trial of the action. RCW 6.40.020 through .040.

T. Participation Agreements

A participation agreement under which a lender sells a participation interest in a loan is enforceable against the lender and is not avoidable in the lender's bankruptcy. *In re Columbia Pacific Mortgage, Inc.*, 20 B.R. 259 (Bankr. W.D. Wash. 1981). This is true even if the participant's interest is not reflected in a public filing in the real estate or personal property records and the promissory note evidencing the debt is not indorsed and delivered to the participant. *Id.* at 262. The court further held that these principles extend not only to the loan itself but also to the collateral for the loan after the selling lender forecloses and takes title to that collateral. *Id.* at 263-64.

XIII. CONCLUSION

This material raises numerous and complex issues. It is provided for general background information only and should not be relied on in specific transactions.

EXHIBIT A

Formatting Requirements For Recorded Documents

The following formatting requirements for documents to be recorded in the real estate records are set out in RCW 65.04.045-.047. They can be enforced very strictly by county recording offices.

1. Requirements for First Page

When any instrument is presented to a county auditor or recording officer for recording, the first page of the instrument must contain:

a. A top margin of at least three inches in which nothing may appear except the “after recording, return to” information, and a one-inch margin on all four sides in which nothing may appear (except that an instrument may be recorded if a minor portion of a notary seal, incidental writing, or minor portion of a signature extends beyond the margins);

b. The top left-hand side of the page must contain the name and address to which the instrument is to be returned;

c. The title or titles, or type or types, of the instrument to be recorded indicating the kind or kinds of documents or transactions contained therein must appear immediately below the three-inch margin at the top of the page;

d. Reference numbers of documents assigned or released with reference to the document page number where additional references can be found, if applicable;

e. The names of the grantor(s) and grantee(s), as defined under RCW 65.04.015;

f. An abbreviated legal description of the property (for purposes of this requirement, “abbreviated legal description of the property” means lot, block, plat, or section, township, range, and quarter/quarter section, and reference to the document page number where the full legal description is included, if applicable); and

g. The assessor’s property tax parcel or account number set forth separately from the legal description or other text.

The information provided on page one of the instrument must be in substantially the following form and is often provided in the form of a cover sheet attached to the document:

When Recorded Return to:

Document Title(s)

Grantor(s): _____

Grantee(s): _____

Abbreviated Legal Description: _____

Assessor's Property Tax Parcel or Account Number: _____

Reference Numbers of Documents Assigned or Released: _____

2. Requirements for All Pages

All pages of the document must be on sheets of paper of a weight and color capable of producing a legible image that are not larger than fourteen inches long and eight and one-half inches wide with text printed or written in eight point type or larger. All text within the document must be of sufficient color and clarity to ensure that when the text is imaged all text is readable. Further, all pages presented for recording must have at a minimum a one-inch margin on the top, bottom, and sides of all pages (except that an instrument may be recorded if a minor portion of a notary seal, incidental writing, or minor portion of a signature extends beyond the margins), be prepared in ink color capable of being imaged, and have all seals legible and capable of being imaged. No attachments, except firmly attached bar code or address labels, may be affixed to the pages.

3. Prohibition of Personal Information

Unless the document is presented for recording by a governmental agency, a document is not recordable if it contains any of the following: (a) a social security number; (b) a date of birth identified with a particular person; or (c) the maiden name of a person so as to be identified with a particular person.

Anchorage
Bellevue
Los Angeles

New York
Portland
San Francisco

Seattle
Shanghai
Washington, D.C.