

Dated: July 26, 2011



George B. Nielsen

George B. Nielsen, Bankruptcy Judge

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF ARIZONA

In re:)	Chapter 11
)	
WASHINGTON COAST I LLC, and)	Case No. 2:08-18608-GBN
)	
STRUCTURAL INVESTMENTS &)	Case No. 2:09-01035-RTB
PLANNING IV LLC,)	
)	(Jointly Administered)
Debtors.)	
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PACIFIC CONTINENTAL BANK and)	Adversary No. 2:09-ap-00553
SONAS CAPITAL GROUP, LLC,)	
)	
Plaintiffs,)	
v.)	FINDINGS OF FACT,
)	CONCLUSIONS OF LAW
RESOURCE FUNDING, INC.,)	AND ORDER
)	
Defendant.)	
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This adversary proceeding seeks to adjudicate the relative priority between creditors Pacific Continental Bank ("PCB") and Resource Funding, Inc. ("RF") regarding proceeds of real property sold by Washington Coast I, L.L.C. ("debtor"). The property, commonly referred to as the "Henningsgaard Parcel," is located in the state of Washington. On December 22, 2008, a voluntary Chapter 11 bankruptcy petition was filed by debtor in the District of Arizona. On January 22, 2009, a voluntary Chapter 11 petition was filed by Structural Investments &

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

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

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

17 **FINDINGS OF FACT**

18 1. Between December 7, 2004 and March 29, 2006, Sonas
19 Capital Group, L.L.C. ("Sonas"), entered into a series of loan
20 transactions to lend funds to SIP IV and Pacific Crest I
21 Development, L.L.C. ("Pacific Crest"). At least five promissory
22 notes were secured by deeds of trust on realty owned by SIP IV
23 and Pacific Crest, including parcels referred to as the
24 Henningsgaard, Morse and Chelson parcels. The trust deeds were
25 recorded in Pacific County, Washington in 2004 and 2005.
26 Pursuant to a loan modification agreement dated December 19,
27 2006, Pacific Crest confirmed it transferred its interest in the

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

11 7. Exhibit 41 is an amendment to a PCB loan to Sonas,
12 executed on October 25, 2006. Exhibit ("ex.") 61 is a file
13 analysis that discusses Sonas loans made to Matt Doney's limited
14 liability companies, Pacific Crest and SIP IV. Secured loan
15 number five was made to SIP IV on a Phase 3 real estate project
16 as a secured transaction with a payoff balance as of December 12,
17 2006 of \$2,681,041.87. Mr. Miller recalls no substantive
18 discussions regarding these transactions, except a brief mention
19 that Matthew Doney was seeking loans from Lynch. The court finds
20 this testimony credible. Miller direct test., Ex. 92 at p. 159.

21 8. The subordination agreement between RF, Pacific
22 Crest, SIP IV, debtor and Sonas was notarized on December 19,
23 2006 and recorded in Pacific County, Washington on December 20,
24 2006. However, Mr. Miller did not see this document until April
25 of 2010 while preparing for his deposition. He had heard about
26 the subordination in early 2009, as Dennis Lynch was collecting
27 Sonas loans. PCB was very concerned as an unauthorized

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

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

1 Doney loan by \$785,453. This modification, which Miller did not
2 sign and did not see, had the effect of impairing PCB collateral
3 by increasing the bank's exposure, in the witness' opinion.
4 However, he conceded that if Sonas had not fully drawn on its PCB
5 credit line at the time of the Doney loan, this might not affect
6 the bank's lien priority. Sonas also agreed to a Doney loan
7 modification on December 19, 2006, the same date as the
8 subordination, in a document that references that a subordination
9 has been given and includes a copy of it. Mr. Miller had no
10 knowledge a PCB lien was purportedly being subordinated. An
11 escrow was established by this modification, through which Doney
12 granted encumbrances to Sonas, who then granted PCB a security
13 interest in the same encumbrances. PCB was not a party to the
14 escrow or the escrow agreements. As collateral parcels were
15 sold, the bank would issue partial releases when it was paid.
16 The witness estimated that Sonas owed the bank approximately \$4.2
17 million. The escrow proceeds for all three parcels would amount
18 to approximately \$3.7 million. The business loan required Dennis
19 R. Lynch to furnish his personal guarantee prior to disbursement
20 of the first loan proceeds. During the time Mr. Miller was
21 responsible for the Sonas file, the Lynch personal guarantee was
22 not released. Miller cross test., Exs. KKK and LLL, Exs. R and
23 43 at p. 217, Ex. EE at pgs. 45-46, pgs. 52-61 and pgs. 63-76;
24 Ex. 40 at p. 147.

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

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

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

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

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

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

12 14. Daniel L. Kerr, the secretary and treasurer of RF,
13 testified it was his responsibility to collect and supervise the
14 construction and commercial loans made by the company. He had
15 never previously dealt with Matthew A. Doney. As RF Vice
16 President, Kerr signed the November 14, 2006 offer to finance
17 construction on Doney's South Salem subdivision. The witness
18 made clear in a November 29, 2006-letter that RF would require a
19 first lien position on the South Salem property, as well as on
20 approximately 40 acres of beach front property in Washington.
21 While the November offer was rejected, there was acceptance of a
22 written RF offer of December 7, 2006 to loan Doney and Don Davis
23 five million dollars to purchase the South Salem property. A
24 first lien position on the South Salem and beach front land was
25 required. At this time, all the information RF had was an
26 appraisal and a location on a map. RF did not engage an attorney

1 to assist it in the five million dollar transaction. December 17,
2 2010 testimony (test.) of Daniel L. Kerr, Exs. 9, 10, Ex. X.

3 15. Upon personally reviewing a Transnation
4 preliminary title report with an effective date of December 7,
5 2006, Mr. Kerr was concerned to learn of the preexisting Sonas
6 liens and assignments to PCB for security. He discussed them
7 with the title company, Doney and others, but had no discussions
8 with PCB. Doney suggested subordination by Sonas. Mr. Kerr
9 agreed. He signed the subordination agreement, which was drafted
10 by Sonas, the first time he saw it. He didn't understand the
11 subordination to be limited and felt it clearly identified RF as
12 the senior lender. The loan closed. On December 19, 2006, Mr.
13 Kerr authorized two title companies to disburse loan proceeds,
14 upon ensuring RF held first lien position on the South Salem
15 property and additional acres in Seaview, Washington. The loan
16 was funded. RF obtained a title policy insuring its first lien
17 position. Kerr test., Ex. 14, Ex. 1, Exs. DD, BB, Ex. 15 at
18 schedule B on p. 54.

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

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

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

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

3 18. Doney left it to Lynch to obtain the
4 subordination, since only Lynch had the relationship with PCB.
5 As the witness phrased it in regard to the senior PCB liens,
6 "Well, that was his problem." Sonas received no consideration
7 for subordinating its liens, other than preserving its
8 relationship with Doney. In the witness' opinion, Sonas was "way
9 over secured" by other collateral they held. He stated that
10 "Dennis is a . . . liar." and characterized allegations as "a .
11 . . lie" that Doney had conversations with Lynch regarding the
12 terms to be utilized in subordinating PCB. The witness also
13 denies being a party to discussions with Lynch regarding Lynch's
14 subordination interactions with the bank or with Pacific County
15 Title. He signed without reading the subordination agreement,
16 prepared by Sonas' attorney David Weiner. He had no interactions
17 with Kerr or anyone else with RF regarding the subordination. He
18 advised Lynch what was demanded by Kerr in order to provide RF
19 its first priority lien. It is likely he received a preliminary
20 title report, but did not read it. He understood from Lynch that
21 PCB authorized the subordination of its assigned Sonas liens.
22 When Doney reviewed the title report at loan closing, the PCB
23 liens were gone. He believes the consequences of the property's
24 tainted title ruined him financially. Doney test. at pgs. 77-
25 96.

26 19. The RF secured loan was acquisition financing.
27 The subordination issue was first raised by Lynch in December of
28

1 2006, probably at least two weeks before closing, as a way to
2 provide RF a first lien. Had Lynch advised he could not obtain
3 a PCB subordination, Doney would not have closed the RF loan.
4 Prior to December 19, 2006, the date the RF loan documents were
5 signed in Salem, up to four subordination agreement drafts had
6 been in circulation. Based on conversations with Lynch, the
7 witness felt a PCB signature was not required on the
8 subordination and RF had been granted a first lien. At the
9 closing, title officer Ms. Kathi Miller was angry with Lynch.
10 The witness now speculates that Ms. Miller probably felt
11 pressured at the time because of her concealed criminal activity.
12 Doney instructed Lynch that a first priority lien had to be
13 provided to RF and felt that Lynch could obtain the PCB
14 subordination. He breezed through the Fidelity title report.
15 Everything seemed to be in order. Subsequently, when in Salem,
16 the witness asked for a copy of the Fidelity report and loan
17 closing documents to include in his file. He observed a release
18 signatory page for PCB and discovered the PCB senior liens
19 remained on the property. Later at a meeting, he cursed Lynch
20 and nearly struck him, when Lynch claimed Doney knew PCB's
21 signature was required for the subordination. Doney never had a
22 conversation with anyone at PCB regarding the dispute, as he had
23 no relationships with the bank. Doney test. at pgs. 98-166.

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

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

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

22
23 ²Subsequently the witness self corrected that Sonas was a
24 limited partnership whose managing partner was RealVest
25 Corporation. Designated deposition of Dennis Lynch of April 27,
2010 ("test.") at pgs. 16-17.

26 ³Since the designations do not clearly establish the
27 witness' qualifications for this legal opinion, the fact finder
will disregard it.

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CONCLUSIONS OF LAW

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

2. Jurisdiction of these jointly administered Arizona Chapter 11 reorganization cases is vested in the United States District Court for the District of Arizona. 28 U.S.C. §1334(a). That court has referred all cases under Title 11 of the United States Code and all adversary proceedings and contested matters arising under Title 11, or related to a bankruptcy case to the United States Bankruptcy Court for the District of Arizona. 28 U.S.C. §157(a); District Court General Order 01-15(1). This adversary having been appropriately referred, this court has core bankruptcy jurisdiction to determine the validity, extent and priority of the parties' liens. 28 U.S.C. §157(b)(2)(K). No party has questioned this court's jurisdiction. See dkt. 100 at ¶ II.

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

1 *Inc.*), 315 F. 3d 1192,1196 (9th Cir.), amended by 326 F. 3d 1028
2 (9th Cir. 2003).

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

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

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

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

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

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

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

14 **ORDER**

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

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22 Copies emailed this 26th day
of July, 2011, to:

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