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UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

FIRST SOUND BANK, a Washington corporation,

Plaintiff,

v.

LARASCO, INC., a Washington corporation;
LOUIS A. SECORD, JR., an individual; and
RICHARD A. SECORD, an individual,

Defendants.

NO. C09-0056 TSZ

DECLARATION OF LOUIS A. SECORD, JR. IN SUPPORT OF DEFENDANTS’ RESPONSE TO FIRST SOUND BANK’S MOTION FOR WRIT OF ATTACHMENT AND PRELIMINARY INJUNCTION FREEZING ASSETS

I, Louis A. Secord, Jr., declare as follows:

I am over the age of 18 and otherwise competent to testify in this matter. I make this declaration based upon my personal knowledge.

1. PUGET SOUND LEASING’S SUCCESSFUL BUSINESS

1.1 With my brother, Richard A. Secord, I founded Puget Sound Leasing Co., Inc. (“PSL”) in 1985. PSL financed the acquisition of personal property to small businesses through the issuance of equipment leases. PSL’s average lease issued was in the amount of approximately \$30,000.00. PSL was in business for 23 years, and through a number of economic recessions, it continued to grow and produce significant profits. By 2007, PSL

1 managed approximately 10,000 equipment leases worth a total of approximately \$250,000,000,
2 and had 65 employees. PSL generated approximately \$4 million in profit for its owners in 2007
3 and did so without requiring any additional investment by its owners.

4 **1.2** As an owner and the President of PSL, I was very familiar with PSL's operations,
5 I was confident it was run competently, and I know that we accurately accounted for PSL's
6 operations, revenues, assets, and accounts receivable agings.

7 **1.3** PSL generated income in a number of ways. First, PSL sold payment streams
8 from its leases to third parties, primarily banks like Banner, Washington Federal and Wells Fargo
9 (the "Investor Banks"). PSL also derived income from servicing these leases. PSL also held its
10 own portfolio of leases which it also serviced and from which it derived revenues.

11 **2. THE LEASING PROCESS**

12 **2.1 Equipment Standards.** PSL through vendors and brokers would obtain
13 applications for leases by businesses seeking to finance their purchase of equipment, vehicles,
14 and other personal property. PSL maintained "Equipment Guidelines" which set forth
15 restrictions on the type of equipment PSL was willing to buy and lease to lessees, as well as
16 limitations on the structure of leases for certain types of property. A true and correct copy of
17 PSL Equipment Guidelines as of October 16, 2008 is attached as **Exhibit A**.

18 **2.2 Strong Underwriting.** PSL also evaluated the creditworthiness of potential
19 lessees and determined, pursuant to strict underwriting standards, whether it was willing to enter
20 a leasing agreement with the potential lessee. A true and correct copy of PSL Credit Guidelines
21 as of January 15, 2006 is attached as **Exhibit B**.

22 **2.3 High Volume and Strict Scrutiny.** Between 2001 and 2007, PSL received
23 anywhere from 2500 to over 6500 lease applications each year. Of these applications, only
24 approximately 50-60% were approved by PSL and approximately 40% were actually carried
25 through to funding by the lessee and a lease agreement executed. A true and correct copy of a
26 summary of PSL's lease applications per month through May 2008 is attached as **Exhibit C**.

1 **2.4 Originating the Leases.** Once PSL agreed to enter into a lease agreement with a
2 lessee, PSL would create the lease documents and have them executed, enter the lease terms into
3 its lease management system, purchase the equipment, have the equipment delivered to the
4 lessee, and then begin collecting payments and servicing the lease per the terms of the lease
5 agreement. PSL funded the equipment purchases with its own working capital. PSL would then
6 batch process a number of these leases to US Bank pursuant to the terms of its \$30 million
7 warehouse line of credit with US Bank. US Bank would then transfer the total amount used for
8 equipment purchases to PSL's account. PSL also entered term loans with other banks (the
9 "Lender Banks") that would finance these equipment purchases on term loans ranging from three
10 to five years.

11 **2.5 Importance of Collections and Recovery Department.** A critical component of
12 the financial success of PSL was its consistently proactive efforts to mitigate the losses from
13 inevitable lease defaults through its collection, recovery and legal efforts. While PSL's
14 collections and recovery department did not generate profit for PSL, it served as the primary
15 means of limiting PSL's losses in the event of default, by providing both immediate returns from
16 the sale of equipment and later returns through its enforcement of personal guarantees and
17 judgments.

18 **3. THE SALE OF PSL TO FIRST SOUND BANK**

19 **3.1 PSL was Approached by FSB.** For the past few years, my brother and I had
20 regularly considered how much longer we wanted to run PSL and in what capacity. We
21 considered selling PSL and/or its portfolios to other leasing companies, various Investor Banks,
22 and even starting our own bank. At the point FSB approached us, we were in negotiations with
23 Terry Peterson, then president of Charter Bank and now president of West Sound Bank, to start
24 our own bank using PSL as the source of initial revenue and growth. Glenn Garrison, an
25 attorney with the law firm of Keller Rohrback, who also represents FSB, was guiding us and Mr.
26 Peterson on the preliminary issues we would face in starting our own bank. While working with

1 Mr. Peterson and Mr. Garrison, FSB came to us and inquired as to whether we would consider
2 selling PSL to FSB. My brother and I were initial investors in FSB. Ultimately, after long
3 discussions with my brother, and because of our existing relationship and personal investment in
4 the newly chartered FSB, we decided to pursue the Asset Sale to FSB.

5 **3.2 The Asset Sale to FSB.** PSL sold substantially all of its assets (the “Asset Sale”) to
6 First Sound Bank (“FSB”) on March 1, 2008 (the “Closing Date”) pursuant to terms of an
7 asset purchase agreement (the “APA”) dated September 1, 2007, entered into by and between
8 FSB, PSL, myself, and my brother Richard A. Secord.

9 **3.3 Employment and Consulting Agreements.** Contemporaneous with the Asset
10 Sale, my brother Lou and I received five-year employment and consulting agreements,
11 respectively. I received an employment agreement for five years at a salary of \$500,000 per
12 year. I was also appointed President of the FSB Leasing Division and appointed a member of the
13 FSB Board of Directors shortly thereafter. My brother received a consulting agreement valued at
14 \$500,000 for the first two years, and \$300,000 for the three following years. We also were given
15 auto allowances and family medical benefits. We also had the ability to expense certain costs
16 through FSB expense accounts. Mr. Hirtzel and Mr. Shaughnessy often encouraged us to do so,
17 but we rarely, if ever, did so, as we felt the compensation FSB provided us was adequate and we
18 personally disagreed with using FSB’s money for these costs. A true and correct copy of my
19 Employment Agreement is attached as **Exhibit V**.

20 **3.4 Formation of Larasco.** As part of the Asset Sale, my brother and I formed
21 Larasco, Inc. (“Larasco”), a Washington corporation, which would serve as a holding company
22 for the remaining PSL assets, some previously acquired FSB stock, and 50% of the recoveries on
23 charged-off leases after the Asset Sale.

24 **3.5 FSB’s Access to PSL Before the Closing Date.** FSB was provided the 2006
25 McGladrey & Pullen, LLP, (“McGladrey”) Audit showing audited financials for 2005 and 2006,
26 as well as PSL’s 2007 financial statements prior to entry of the APA. A true and correct copy of

1 McGladrey’s PSL Audited Financial Report through December 31, 2006 (the “2006 McGladrey
2 Audit”) may be found in the Gould Declaration, Docket 12, Ex. A, pp. 7-35. From September
3 2007 to March 2008, FSB had over six months of access to PSL’s business, books, and records,
4 and employees between the entry of the APA and the Closing Date to perform its due diligence.
5 The only FSB employee who came to PSL’s offices during this time for purposes of reviewing
6 PSL’s financial and accounting practices was Mary McDonald, Chief Credit Officer of FSB.
7 Ms. McDonald spent approximately four hours reviewing our lease portfolio of approximately
8 10,000 leases. Ms. McDonald stated to me and Doug Blair, then CFO of PSL (an FSB employee
9 as of the date of filing) that she had seen everything she needed and was satisfied with her due
10 diligence. Mr. Hirtzel, Mr. Shaughnessy, and Ms. Gould did not come to PSL to inspect our
11 books and records or discuss the details of how we operated PSL. No FSB representative or
12 outside consultant ever expressed to me or my brother any frustration or concern over the access
13 or information they were provided during the lengthy due diligence period.

14 **3.6 PSL Was Operated Like a Well Run Leasing Company.** I do not believe I
15 ever stated to Mr. Hirtzel, Mr. Shaughnessy, Ms. Gould, or any other member of FSB’s
16 management, that PSL was run “like a bank.” I did likely and accurately state that PSL had
17 strong underwriting practices, collections procedures, business practices, was generally risk
18 adverse, and had grown conservatively over the years. PSL was privately held by my brother
19 and me and was not subject to the same accounting regulations as FSB, but PSL did apply
20 Generally Accepted Accounting Practices (“GAAP”). From 2003-2007, PSL was managed to
21 attain a growth rate of approximately 15% per year. This growth was reasonable and well
22 managed. This growth was slower than it could have otherwise been during this period of rapid
23 global economic growth. Because PSL was averse to both debt and risk, PSL did not borrow
24 funds to meet operational expenses and aimed to retain a leverage ratio of approximately 3 to 1.
25 During this same time other financing businesses and banks were levered up to 40 to 1.
26

1 **3.7 Unpaid Amounts Due for Residuals Retained.** Under the terms of the Asset
2 Sale, PSL sold to FSB two different classes of lease assets: (1) PSL’s “Held Portfolio”; (2) PSL’s
3 rights and interests to a majority of leases in its “Sold Portfolio”; (3) PSL’s Inventory of
4 repossessed property; (4) and other fixed assets. Based on FSB’s General Ledger Balance Sheet
5 for the Period Ending February 29, 2008, those sold residuals retained on sold leases was only
6 approximately \$2,274,000 not \$3,800,00 as FSB suggests. *See* Gould Declaration, Dkt. 12, Ex.
7 C, p. 79. As part of the Asset Sale, Larasco was to retain \$715,000 in residuals from these
8 leases. As of the signing of this declaration, FSB has yet to pay Larasco any of the \$715,000 in
9 residuals FSB owes to Larasco.

10 **3.8 Repossessed Property.** With respect to the repossessed property valued at
11 \$476,513 as of March 1, 2008, FSB was never entitled to cash in this amount. Rather it was
12 entitled to the property itself. FSB chose not to audit this inventory prior to the Closing Date.
13 Presently, FSB has possession of this property, but has closed the recovery operation and in
14 doing so has ceased its efforts to market and sell this equipment. By doing so FSB has harmed
15 itself, as these assets continue to lose value during the present economic downturn.

16 **4. CLOSING THE ASSET SALE AND THE MONTHS THEREAFTER**

17 **4.1 FSB Purchased No Leases Over 60 Days Past Due at Closing.** On the Closing
18 Date, March 1, 2008, FSB was aware of and had been aware of the agings on all leases it was
19 purchasing from PSL. FSB was specifically aware of which leases were 30, 60, and 90 days past
20 due because the parties agreed that FSB would not acquire any leases which as of February 29,
21 2008, would have been more than 60 days past due. If a lease was 30 days past due on the
22 Closing Date, and no further payments were made, this lease would be 180 days past due on July
23 31, 2008. If a lease was 60 days past due at March 1, 2008 and no further payments were made,
24 this lease would be 180 days past due on June 30, 2008. Not surprisingly, by July 31, 2008,
25 certain of these leases would be approaching 180 days past due and, under banking regulations
26 imposed upon FSB, they were required to be charged-off. This 180-day charge-off of statutory

1 bad debt did not apply to PSL when it was a privately held leasing company. This requirement
2 was a banking regulation FSB was aware of, or should have been aware of, when it sought to
3 purchase PSL.

4 **4.2 Market Deterioration.** As part of the current, historic economic downturn
5 between March 1, 2008 and July 2008, the leasing and financial sectors began precipitous
6 declines. Losses incurred in these sectors began to build rapidly during this period and continue
7 to grow as of the date of the signing of this declaration. This has been the deepest and most
8 rapid declines I have ever experienced in this industry. During this same time, credit markets
9 tightened rapidly and dramatically in a way that has greatly impacted lessees' ability to access
10 alternative forms of credit to ensure they remain current with their obligations to PSL.

11 **5. PSL's ACCOUNTING AND TAX PRACTICES**

12 **5.1 Annual Audits of PSL**

13 **5.1.1** For more than 10 years, PSL was voluntarily audited by independent
14 auditors. Each year these auditors would review PSL's company prepared financial records and
15 accounting procedures (the "Annual Audits"). Investor Banks and Lender Banks regularly
16 requested and relied upon these Annual Audits in the course of confirming the sound business
17 and accounting practices of PSL.

18 **5.1.2** The lease payment stream portfolios FSB purchased from PSL prior to the
19 Asset Sale were audited at least annually to verify portfolio performance and recordkeeping.
20 PSL and FSB shared the same outside auditor, McGladrey.

21 **5.1.3** The 2006 McGladrey Audit for the 12 months ending December 31, 2006,
22 resulted in no changes to the PSL financials prepared by then PSL Chief Financial Officer, and
23 now FSB employee, Doug Blair. FSB did not request 2007 audited financials as part of the
24 Asset Sale or their due diligence.

25 **5.1.4** Upon completion of the Asset Sale, FSB commissioned an in-depth
26 analysis of the lease portfolio by Moss Adams, LLC in July 2008. My brother and I do not have

1 a copy of the full Moss Adams audit report. But I did receive a summary of this report from
2 fellow board member James Jackson, a CPA and Chairman of the FSB Audit Committee, while I
3 was still a member of the FSB Board. After reviewing the Moss Adams report, Mr. Jackson
4 summarized it by stating he was “happy to report there are no serious deficiencies.” Attached as
5 **Exhibit D** is a true and correct copy of this summary. The only way I can adequately defend
6 against FSB’s allegations is if I am given access to the numerous audit reports in FSB’s
7 possession, including the July 2008 Moss Adams report.

8 **5.2 The Internal Revenue Service’s 2001 Audit of Tax Years 1998-1999**

9 **5.2.1** In 2001, PSL was subject to an audit by the Internal Revenue Service for
10 the tax years ending 1998-1999. During this audit, a team of IRS auditors who specialized in
11 auditing financial service companies spent 10 months in the PSL offices reviewing financial
12 information and tax practices. This audit included specific attention to the depreciation methods
13 of PSL and PSL’s treatment of security deposits. Following 10 months of review, the IRS
14 blessed PSL’s accounting and tax practices by issuing a “No Change” letter informing PSL the
15 IRS audit resulted in no changes to PSL’s prepared tax returns. Attached as **Exhibit E** is a true
16 and correct copy of this letter. PSL was previously audited by the IRS on multiple other
17 occasions with similar results. In 2004, the IRS considered auditing PSL again, but after
18 reviewing PSL’s tax returns, determined a formal audit was unnecessary. Attached as **Exhibit F**
19 is a true and correct copy this IRS determination letter.

20 **5.3 PSL Made No Representations to FSB Regarding Tax Benefits of the Leasing**
21 **Business.** I did not, nor did my brother, represent to FSB any of the tax benefits of the leasing
22 business or anything regarding how FSB would be taxed when it purchased PSL. FSB has its
23 own accountants and auditors that could and should have advised it about the tax implications of
24 buying PSL before entering the APA and certainly during the due diligence period. PSL was not
25 aware of or responsible for the accounting and tax practices of its lessees.

26 **5.4 Residuals and “Put-Letters” or “Put-Riders”**

1 **5.4.1** There were generally two parts to each lease transaction: (1) the lease, and
2 (2) the residual “Put-Letter” or “Put-Rider.” The Put-Letter was a separate agreement between
3 the lessee and PSL that provided at what price the lessee could purchase the equipment at the end
4 of the lease. If PSL had included the purchase price in the lease agreement, it would have been a
5 loan and not a lease.

6 **5.4.2** These Put-Letters or Put-Riders generally provided for the lessee to
7 purchase the equipment either for \$1, or at a negotiated and stated value. PSL never issued a
8 Fair Market Value or “FMV” Put-Rider in its 23 year history. If it was the intention of the lessee
9 and PSL to provide for the purchase of equipment at its fair market value at the time of sale, no
10 such letter would be issued.

11 **5.4.3** In 2001, because a number of Put-Letters that were stored in PSL’s
12 general office area had been misfiled or lost by PSL employees, PSL staff was instructed to pull
13 all Put-Letters from lease files. Those worth \$1 were not retained because they were of no value
14 to PSL. Because of their importance and to avoid future problems with Put-Letters being
15 misfiled or misplaced, those letters which provided for stated values were all then moved to my
16 office, where clerks had access to them only for purposes of lease settlements.

17 **5.4.4** Similarly, because of their importance, we kept title and registration
18 documents to all titled vehicles in a secure location.

19 **6. PSL’S SALE OF LEASE PAYMENT STREAMS TO INVESTOR BANKS**

20 **6.1 The Sale of Lease Payment Streams.** PSL made much of its income from the
21 sale of the payment streams due under these leases to Investor Banks (“Sold Portfolios” or “Sold
22 Leases”). Six to eight times each year, PSL would package a group of leases, usually around 200
23 leases, it had funded and begun servicing. These leases would be presented to potential Investor
24 Banks who would be interested in acquiring their payment streams in exchange for a present
25 value payment. Valued at an average of \$30,000 per lease, these leases represented
26 approximately \$5 to \$10 million of future payment streams. The Investor Banks offering the

1 most favorable terms would then be given the opportunity to review the portfolio of leases for
2 sale, and use their own criteria to determine which individual leases they desired to purchase.
3 PSL always provided Investor Banks and Lender Banks the opportunity to share with each other
4 information about the leases for sale so they could determine if any other banks had previously
5 acquired an interest in the equipment. Banks then executed “Inter-Creditor Agreements”
6 acknowledging they had no interest in the leases being sold to the Investor Bank in the current
7 portfolio offering. Once the Investor Bank had hand-selected the leases they wished to purchase,
8 a present value calculation of the payment streams would be made and sent to the Investor Bank
9 for confirmation. The Investor Banks would then wire the funds to US Bank, who would apply
10 them to PSL’s warehouse line of credit, send the excess funds to PSL’s checking account, and
11 send the original loan documents to the Investor Banks. Shortly thereafter, the Investor Banks
12 would begin receiving, directly from PSL, the monthly payments due under the terms of the
13 leases purchased, even if PSL was not receiving payments from the lessee.

14 **6.2 Terms of Sale.** Under the terms of the lease payment stream purchase and sale
15 agreements (the “Program Agreements”) under which the Investor Banks purchased the Sold
16 Portfolios, the Investor Bank acquired only the rights to the payment stream due from the leases.
17 PSL retained all remaining rights and obligations under the leases, including the obligation to
18 service the leases. These rights held by PSL included: (1) residuals – the payment by lessee at
19 the end of the lease which enabled it to purchase the equipment from PSL for either a nominal
20 amount or a stated amount); (2) the rights to collect legal settlements and judgments, as well as
21 fees and costs associated with recovery of delinquent accounts or lease defaults; (3) rights to the
22 security deposits in the event of default; and (4) ownership of the equipment itself, until it was
23 purchased by the lessee or the lease was terminated. In essence, the Investor Banks simply
24 bought, at present value, the right to receive monthly payments from PSL over the average 3-5
25 year lease terms, while not taking any of the burden and costs of servicing the lease itself. The
26 service functions provided by PSL included billing and collecting payments from the lessee, as

1 well as ensuring insurance premiums, personal property taxes, state and local taxes, and the like
2 were paid, even if PSL had not yet received these amounts from the lessee.

3 **7. PSL'S NO-LOSS PRACTICE**

4 **7.1 The No Loss Practice.** Over the course of our 23 years in the leasing business,
5 PSL made every single payment to every Investor Bank without exception. We referred to this
6 as PSL's "No Loss Practice." PSL did not simply "forward" payments to the Investor Banks. It
7 was PSL's business model and practice to ensure Investor Banks were timely and fully paid each
8 month, regardless of whether PSL had received payment from the lessee. The No Loss Practice
9 was not required by the terms of the Program Agreements, but it served an important role in the
10 development of PSL's reputation in the leasing industry and was also critical to the revenues of
11 PSL, as the Program Agreements generally provided for an incentive payment to PSL from the
12 Investor Bank in the event all payments due to the Investor Banks were timely paid. The No Loss
13 Practice also served as the primary reason the Investor Banks were willing to provide favorable
14 terms to PSL to purchase the lease payment streams. Between 2002 and 2007 PSL was paid
15 incentives or entered incentive agreements to be paid a total of over \$276,000. This revenue
16 depended on PSL's continued performance of its 23-year No Loss Practice. Attached as
17 **Exhibit G** is a true and correct copy of PSL's Portfolio Sales Performance Incentives 2002-
18 2007.

19 **7.2 FSB Understood the Important of the No Loss Practice.** FSB was fully aware
20 of the No Loss Practice and its importance to the future of the business it was acquiring from
21 PSL in the Asset Sale. Before, during, and after the Closing Date, FSB represented to us and the
22 Investor Banks who relied on this practice when choosing to purchase the lease payment streams
23 from PSL that FSB would continue this practice.

24 **7.3 Comfort Meeting Between FSB and Washington Federal Savings.** On May
25 29, 2008, I attended a lunch with Mr. Hirtzel, Doug Blair, and Steve Shaughnessy hosted by
26 Washington Federal Savings/First Mutual Bank in which I, along with Mr. Hirtzel, and Mr.

1 Shaughnessy, represented to Rick Collette, the Executive Vice President of Washington Federal
2 Savings/First Mutual Bank, that the No Loss Practice, known to Washington Federal Savings as
3 “Perfect Pay,” would be continued by FSB.

4 **7.4 FSB Sent Comfort Letters to Investor Banks.** Attached as **Exhibits H and I**,
5 are true and correct copies of two “comfort letters” sent by Mr. Hirtzel, Chairman and CEO of
6 FSB, to Ron Worth, Vice President of Washington Federal/First Mutual Bank, in June of 2008 in
7 which he assures Mr. Worth that after the Closing Date, the “administration of the lease portfolio
8 and subsequent lease stream sales is anticipated to operate as it has in the past under the former
9 [PSL].” In his letter of June 6, 2008 (**Exhibit I**), Mr. Hirtzel’s letter also references “Note 11 –
10 Commitments” of the 2006 McGladrey Audit and attaches page 23 of the 2006 McGladrey Audit
11 which states, “It has been the Company’s policy, but not its obligation, to continue to the
12 payment of the lease stream, even if the lease is nonperforming.” FSB was fully aware of the
13 importance of continuing the No Loss Practice to the business model of PSA and profited from
14 assuring Investor Banks it would continue to do so.

15 **7.5 FSB’s Abandonment of the No Loss Practice.** However, despite providing
16 assurances to Investor Banks, like Washington Federal/First Mutual Bank, that it would continue
17 the No Loss Practice, FSB soon abandoned the No Loss Practice and stopped making payments
18 to Investor Banks when leases became delinquent or needed to be charged-off and paid-off. This
19 was very problematic for Investor Banks who purchased lease portfolios based on FSB’s
20 assurances it would continue the No Loss Practice. Attached as **Exhibit J** is a true and correct
21 copy of an email from Mr. Shaughnessy to FSB attorney Glen Garrison regarding FSB’s
22 response to an attached demand letter from Washington Federal Savings/First Mutual Bank (the
23 “Washington Federal Savings Letter”). The Washington Federal Savings Letter requests that
24 FSB repurchase an almost \$7,300,000 portfolio of lease payment streams which Washington
25 Federal Savings/First Mutual Bank had purchased on June 27, 2008 based on the representations
26

1 by FSB in the comfort letters and at the May 29, 2008 comfort meeting that FSB would continue
2 the No Loss Practice.

3 **7.6** FSB executives, including Mr. Hirtzel and Mr. Shaughnessy, repeatedly assured
4 me and my brother that following the Asset Sale, we would be empowered to operate PSL as we
5 had always operated it, including continuation of the No Loss Practice. We relied on these
6 representations and assurances in negotiating and ultimately going forward with the transaction.
7 This was material in our decision to accept a six-year earnout as part of the consideration for the
8 Asset Sale. We urged FSB to seek shareholder approval of FSB's contemplated purchase of PSL,
9 but FSB determined it was not required and refused to obtain it.

10 **7.7** After execution of the APA, FSB, Hirtzel and Shaughnessy continued to assure
11 me and my brother that even after closing we would be able to run PSL as we always had. FSB,
12 Hirtzel and Shaughnessy specifically and repeatedly confirmed that FSB would continue the No
13 Loss Practice that was key to the satisfaction of the Investor Banks and a cornerstone of PSL's
14 success.

15 **7.8** After FSB terminated the No Loss Practice, we tried to work around this
16 impediment, but began to clash with FSB and its management team with increasing frequency.
17 For example, I was forced to resign from the FSB Board of Directors in response to Mr.
18 Shaughnessy's inappropriate and threatening conduct, as well as the subsequent removal of me
19 from the FSB Loan Committee in retaliation for my questioning of a certain loan request.

20 **7.9** In mid-November 2008, my brother was informed by Mr. Hirtzel and Mr.
21 Shaughnessy that neither he nor I had any further authority over FSB's Leasing Division. FSB
22 confirmed it would continue making salary payments under my Employment Agreement and my
23 brother's consulting fee payments under his Consulting Agreement. In early December, Mr.
24 Hirtzel informed me that I was excused from attending Board meetings for the time being.

1 **8. PSL’S DELINQUENCY RATE**

2 **8.1 Delinquency and Default.** On occasion, PSL did not receive timely payments
3 from lessees and experienced other defaults by lessees under the terms of the lease agreements.
4 Pursuant to PSL’s No Loss Practice, PSL continued to pay Investor Banks the amounts due on
5 these leases, even when it had not yet received payment. PSL developed and maintained a
6 strong, lawful, and effective collection and recovery department, which combined with its
7 thorough credit underwriting process, generally resulted in low delinquency rates on its leases.
8 A lease is “delinquent” when payments due and owing under the lease agreement have not been
9 paid. A lease may be in “default” for any number of reasons, pursuant to the terms of the lease
10 agreement, whether or not it was in fact delinquent. As part of its leasing practices, PSL kept
11 meticulous track of whether or not any of its leases were either delinquent or in default, whether
12 they be leases held by PSL or those whose payment streams had been sold to Investor Banks but
13 were still serviced by FSB. Attached as **Exhibit K** is a true and correct copy of a summary of
14 PSL’s Collection Results from January 1999 to November 2007 (the “PSL Delinquency
15 Report”).

16 **8.2 Calculating the Delinquency Rate.** The delinquency rate (the “Delinquency
17 Rate”) is calculated by dividing the amount of future payments remaining unpaid on any
18 delinquent leases (the “Contract Balance Remaining”) by the total value of the payments
19 remaining on all leases (the “Total Contract Balance Remaining”). The Delinquency Rate is
20 subject to constant fluctuation based on, at a minimum, the economic conditions facing lessees,
21 the availability of other credit to lessees so they could borrow funds to remain current with their
22 obligations to PSL, and the effectiveness of PSL’s collection and recovery efforts. While it was
23 PSL’s goal to keep its Delinquency Rate under 1%, this rate occasionally reached as high as
24 2.67% or more. Regardless, based upon my years of experience in the financial services industry
25 and my continual monitoring of delinquency rates, even rates as high as 3% on similar
26 obligations would be considered acceptable.

1 **8.3 The Delinquency Rate was an Important Performance Metric for PSL.**

2 PSL's No Loss Practice was to pay Investor Banks the full amounts due under the leases,
3 regardless of whether PSL received those amounts from lessees. The money to pay the Investor
4 Banks obviously had to come from somewhere. Payments made according to the No Loss
5 Practice were paid from PSL's own earnings during that period as PSL only borrowed money
6 from Lender Banks for the purpose of funding current leases. No Loss Practice payments had a
7 direct impact on PSL's profits, and so PSL placed a premium on keeping its delinquency rate to a
8 minimum.

9 **8.4 PSL's Delinquency Rates Were Always Changing.** In the month of December

10 2006, the Delinquency Rate of PSL was 0.29%. This was the result of PSL's active and
11 successful collections practices, which had lowered this rate from as high as 0.78% in February
12 2006. The average delinquency rate for 2006 was 0.64%. 2006, however, was an exceptional
13 year. It was also normal for PSL's delinquency rate to be far lower in December than in other
14 months of the year as many of PSL's lessees desired to start the new year current on all
15 obligations. Given the availability of easy credit in the financial markets over recent years,
16 which perhaps reached its apex in 2006, lessees were generally able to obtain alternative
17 financing by refinancing homes, obtaining home equity lines of credit, or even low interest credit
18 cards to obtain the money necessary to stay current with PSL. These market conditions drove
19 down PSL's Delinquency Rate dramatically. PSL had always had a target of 1%, but often
20 experienced Delinquency Rates in excess of 2.5% in any month given the variety of factors that
21 could influence this rate. See PSL Delinquency Report (**Exhibit G**); See also Shaughnessy
22 Declaration, Exhibit A, Docket 17-2, p. 12.

23 **8.5 Monthly Agings were Provided to All Banks.** PSL, as part of its monthly

24 statements to both Investor and Lender Banks, would provide aging reports showing (1) which of
25 the leases they purchased from or financed for PSL were delinquent, (2) what amounts were
26 outstanding, and (3) whether these amounts were either 30, 60, or 90 days past due. This

1 information was useful to the Investor Banks because it allowed them to monitor the quality of
2 the leases they were purchasing from PSL and their own credit underwriting procedures. The
3 Investor Banks ultimately had no cause for alarm or concern because PSL's No Loss Practice
4 ensured the Investor Banks were timely and fully paid each month regardless of the
5 delinquencies of the leases. Nevertheless, accurate aging reports allowed Investor Banks to
6 inquire of PSL and to ensure that PSL was doing all it reasonably could to collect what was owed
7 on leases. Investor Banks were obviously most secure if the No Loss Practice never needed to be
8 applied.

9 **8.6 Effect of Lease Charge-Offs on the Delinquency Rate.** Occasionally, for any
10 number of reasons, after a lease had gone delinquent, been determined to be in default by myself,
11 and collections efforts had been exhausted, there were certain lease obligations which were no
12 longer likely to be recovered. This was of no consequence to Investor Banks because while
13 collections efforts were made, PSL continued to pay the monthly payments due under the
14 Program Agreements to the Investor Banks, even though PSL may not have received payments
15 from the lessee and these payments were not required by the terms of the Program Agreements.
16 Then, when I determined continued efforts were not likely to result in additional recovery from
17 the lessee, these leases would be "charged-off." Consistent with its No Loss Practice, PSL would
18 make a payment to the Investor Bank holding the charged-off lease, a payment based on the
19 present value of the remaining payments due under the terms of the lease. This would not only
20 make the Investor Banks whole, but would provide them with an increased benefit by an early
21 return on their investment in advance of when they would otherwise have if PSL simply
22 continued to make monthly payments. This present value payment was not required by the
23 Program Agreements; in fact, those Agreements were expressly non-recourse to PSL and
24 Investor Banks bore the risk of charge-offs. This final application of the No Loss Practice, like
25 all of PSL's business practices, was never questioned by any of the numerous audits of PSL by
26 its own independent auditors, those auditors of the Investor Banks, nor by the Internal Revenue

1 Service, by FSB as an Investor Bank, or by FSB during the 6 months in which it had unfettered
2 access to PSL's books between the signing of the APA and the Closing Date.

3 **8.7 Month-End Reconciliations on PSL's Delinquency Rate.**

4 **8.7.1 Month-End Tasks.** At the end of each month a number of events would
5 need to be completed before PSL could run its reports and obtain accurate month end financial
6 and accounting information. One such regular event was receipt of payments collected by the
7 recovery division on delinquent accounts. Amounts collected during each month on a specific
8 account would then be posted to that account as received during the month it was collected. On
9 occasion, the last business day of the month would fall on a weekend or holiday, or the recovery
10 division would be unable to deliver the collected payments prior to the end of the month. Also, it
11 was not until the end of the month that forfeited security deposits would be applied because PSL
12 did not want to post forfeited security deposits earlier in the month only to have to reverse them
13 when lessees sent their payments on the last day of the month. This process of settling accounts
14 at the end of each month often took a couple of days to ensure that all payments received and
15 security deposits posted to delinquent payments were recorded appropriately with respect to the
16 month they were received or forfeited.

17 **8.7.2 InfoLease.** PSL's original, custom accounting system allowed for these
18 month-end reconciliations. Under PSL's new InfoLease accounting system, which it began to
19 employ in 2007 (as described in ¶ 10, below), this settlement process was not allowed. Any
20 amount received or posted shortly after the end of the month would be applied to the next month,
21 even though it was timely paid and received the prior month. As a result, the Delinquency Rate
22 inaccurately rose because the payments were timely received and the security deposits forfeited,
23 but the InfoLease system would show them as delinquent for the prior month, even if the leases
24 were immediately current the next day. In an April 11, 2008 review by Stacia Stratton, an
25 independent outside auditor, hired by FSB to audit the lease portfolio post-closing which was
26 provided to James Jackson (FSB's Audit Committee Chairman), Mr. Hirtzel, and Mary

1 MacDonald, Ms. Stratton addressed this issue directly. A true and correct copy of Ms. Stratton's
2 report is attached as **Exhibit L** (the "Stratton Report"). In her report, Ms. Stratton stated,

3 "The past due percentages increased from .82% in October 2007 to 2.54% in
4 November, immediately after conversion to the new lease accounting system. At
5 month-end in February 2008, the past-due percentage has increased to 2.96%.
6 Part of the problem is that monthly payments that are short by a small amount –
7 perhaps due to added fees or an increase in sales tax in a particular state, are
8 reflected as past due. These issues have not yet been resolved and SVP Steve
9 Twidwell estimates that the actual delinquency is closer to 1.25%."

10 See Stratton Report, p. 1, ¶3 (emphasis added).

11 **8.8 Jennifer Wright Did Not Calculate PSL's Delinquency Rate.** Jennifer Wright
12 was not the employee responsible for calculating PSL's Delinquency Rate. Ms. Wright had
13 nothing to do with the calculation of this rate. The Delinquency Rate was calculated by Steve
14 Twidwell, the Senior Vice President and manager of the customer service and collections
15 departments. Mr. Twidwell was retained by FSB after the Asset Sale, but has since taken
16 medical disability leave. It is my understanding that FSB has informed him he is not welcome to
17 return to FSB if his condition improves.

18 **8.9 Thaes St. Pierre's Responsibility at PSL Was a Clerical One.** Thaes St.
19 Pierre's primary responsibilities included booking leases into the lease management and
20 accounting system and originating payments to Investor Banks. Ms. St. Pierre had no knowledge
21 of agings and was not involved in collections. She was aware that we were paying all of the
22 Investor Banks timely and in full, even when PSL had not received payment, but this was part of
23 PSL's 23 year No Loss Practice that was repeatedly blessed by annual audits, the IRS, the
24 Investor Banks, and the Lender Banks.

25 **8.10 Tammy Kady's Responsibility at PSL was a Clerical One.** Ms. Kady's
26 primary responsibility was processing new leases. She reviewed submissions from lease brokers
and vendors, ran credit reports, and prepared lease applications for review by the credit
managers. She had no accounting responsibilities and had no contact with me relating to
accounting, PSL business practices, or credit approvals.

1 **8.11 180-Day Statutory Bad-Debt for Banks.** Prior to the asset sale, PSL was not
2 governed by the banking regulations that apply to FSB. FSB was aware of this. The statutory
3 requirement to write-off receivables that were over 180 days old was not applicable to PSL until
4 it became the leasing division of FSB after the Asset Sale. PSL was profitable and successful
5 over its 23 years in large part because of its collections and recovery efforts. Many of these
6 efforts took place long after 180 days, and FSB was aware of this practice and this aspect of
7 PSL’s business when it purchased it. Because PSL was not governed by banking regulations
8 requiring it to write-off as losses those leases which were over 180-days past due until the Asset
9 Sale, these receivables were simply accounted for differently by FSB after the Closing Date.
10 FSB was aware of all PSL’s lease agings as it received them monthly, and could have easily
11 determined the potential effect if the 60 day delinquencies it purchased became over 180-days
12 past due after it purchased PSL’s assets.

13 **8.12 PSL’s Collection of Interim Rental**

14 **8.12.1 Definition.** Like apartment rent or cell phone bills, equipment lease
15 payments are paid in advance, not arrears. Where a lease commences in the middle of a month,
16 there is an amount due for the partial month in which the lessee had the benefit of the equipment
17 before the first full month of the lease (“Interim Rental”). See Docket 17-2, p.70. (“6.
18 INTERIM RENTAL. Lessee acknowledges and agrees to pay Interim Rental which is calculated
19 by dividing the monthly payment by 30 days which equals a daily rate. The daily rate is
20 multiplied by the number of days between the lease acceptance date and the first lease payment
21 due date.”)

22 **8.12.2 Billing and Default.** These Interim Rental charges were billed with the
23 first payment on each lease and appeared on all subsequent invoices until paid in full. Failure to
24 pay interim rent was a form of default.

25 **8.12.3 Collection of Interim Rent was Proper.** PSL’s practice of declaring
26 leases in default if a lessee failed to pay interim rent was approved by every PSL Annual Audit

1 to date. FSB was aware of this legitimate enforcement of PSL's leases when it purchased PSL.
2 Ms. Gould is a CPA and was fully aware of this practice and compliance with GAAP. If there
3 were GAAP rules requiring PSL treat these differently, PSL would have done so, or this issue
4 would have appeared in any one of the numerous Annual Audits, or the IRS audits.

5 **8.13 PSL's Application of Collections Proceeds**

6 PSL regularly and appropriately credited lessees' accounts with all amounts PSL
7 recovered from its collection and recovery efforts whether as the result of a sale of repossessed
8 equipment or funds from a lease guarantor. Upon recovery, PSL properly reduced the balance
9 owed by the lessee under the lease. If these amounts were sufficient to bring the lessee's balance
10 current, the lease would no longer appear delinquent. If these amounts generated a surplus, they
11 could be viewed as "paying ahead" the lease because the lease management software would
12 show that payments had been made in an amount greater than was due and owing. This method
13 of tracking of funds was important as it would reduce the amount still owing under the lease and
14 help determine important items like the correct amount of any judgment obtained.

15 **8.14** PSL did not recognize any residual payments as income unless and until the
16 residual payment was received by PSL.

17 **9. PSL'S TREATMENT OF LEASE PAY-OFF'S AND CHARGE-OFF'S**

18 **9.1** I do not believe I ever stated to Mr. Hirtzel, Steven Shaughnessy, or to Ms. Gould
19 that PSL's charge offs were "insignificant." I did likely, and accurately, state that these amounts
20 were often a fraction of a percent. However, considering that the value of the leases sold to FSB
21 in the asset sale was approximately \$250 million, a charge-off of 1% would equal approximately
22 \$2.5 million. The \$2,085,000 FSB claims it was forced to take after writing off all receivables
23 over 180 days old according to its banking regulations represents less than a 1% charge-off rate
24 which is exceptionally low in the financial services industry, especially in light of the current
25 economic conditions facing the industry, and is consistent with PSL's prior annual charge-off
26 amounts. See 2006 McGladrey Audit, p. 15.

1 **9.2** PSL’s charged-off leases in 2006 were \$229,192 for the approximately \$25
2 million portfolio owned by PSL at the time. This represented a less than 1% charge-off rate and
3 was in large part due to PSL’s active and successful collection and recovery practices, and the
4 credit-friendly market conditions of 2006. In 2005, PSL experienced a similar charge-off of
5 \$246,473 on a \$26 million portfolio of leases owned by PSL that year. See 2006 McGladrey
6 Audit, pp. 15-16. FSB has no basis to claim that the charge-offs it recorded were a surprise or
7 larger than what it reasonably should have expected as they are about 1% of its portfolio.

8 **9.3** The effect of the lease charge-offs was to remove them from the lease
9 management and accounting system, because by paying off the remaining amounts due to the
10 Investor Bank (even though PSL was not required to do so), there would no longer be an
11 obligation to the Investor Bank. Although removed from the accounting system, the lease would
12 be recorded in PSL’s collection and recovery system and still represented a potentially valuable
13 receivable.

14 **9.4** This process of accounting for charged-off leases was well known to FSB as an
15 Investor Bank and was approved by PSL’s and FSB’s own trusted auditor, McGladrey, on
16 multiple occasions. It is also notable that in 2006 while PSL had a charge-off loss of
17 approximately \$229,000, it also posted revenue of approximately \$400,000 from recovery efforts
18 on previously-charged off leases. This provided for a net gain of \$170,000 from PSL’s recovery
19 operations. These payments often were remitted to PSL by former lessees seeking to have
20 judgments held by PSL released so the lessee could refinance his or her home or obtain other
21 forms of financing. Even after PSL’s active recovery efforts ceased, its practice of obtaining and
22 enforcing judgments continued to lead to revenue even years later. See 2006 McGladrey Audit,
23 p. 16.

24 **9.5** The \$229,192 charge-off amount in 2006 represents those amounts written off as
25 losses after the application of amounts derived from collection efforts, application of proceeds
26 from recovery and sale of equipment, and the application of forfeited security deposits. This

1 \$229,000 amount does **not** include those charge-offs which would be attributable to amounts
2 charged-off on leases serviced by PSL but whose payment streams were sold to Investor Banks.
3 The reason for this is simple. At the time PSL charged-off a lease in a Sold Portfolio, it removed
4 the lease from its lease management system and paid the Investor Banks the present value of
5 remaining payments in full under its No Loss Practice. This amount was simply netted against
6 PSL's gain on the sale of lease streams sold to all Investor Banks during that period. This
7 practice is consistent with GAAP. Most importantly, this practice was established by PSL's
8 auditor, McGladrey, who was also FSB's auditor. PSL did not make this allocation arbitrarily.
9 PSL was directed to do so by its auditor, McGladrey, to ensure PSL remained in compliance with
10 GAAP.

11 **9.6 No Obligation to Immediately Charge-Off Delinquent or Defaulted Leases.**

12 In the leasing industry there exists no affirmative obligation to charge-off leases immediately
13 upon delinquency and/or other defaults. This concept is untenable, because if PSL charged-off
14 every lease immediately upon default or delinquency, there would never be an aging report. Is
15 PSL did this, all leases would either appear current, or would be removed from the system
16 because they were charged-off.

17 **9.7 PSL's Process and its Approval by Auditors.**

18 In the leasing industry, there are generally two types of lease pay-offs or charge-offs. The first type is a "Lessee Pay-Off" which
19 occurs when a lessee desires to pay-off the balance of their lease. Generally, the lessee would
20 call PSL, get a pay-off quote, and send a check to PSL. Upon posting of the check, the lease is
21 removed from the leasing system as it has been paid in full. This is desirable for the Investor
22 Bank because, instead of getting the remaining monthly payments from PSL, it would receive a
23 single check for the present value of all amounts remaining due for that lease. This practice is
24 consistent throughout the leasing industry and was never challenged in any of the independent
25 audits of PSL, by FSB's auditors, by FSB as an Investor Bank, the IRS, or by FSB during the
26 due-diligence period. The second class of pay-offs are "Default Pay-Offs" or "Default Charge-

1 Offs” due to defaulted leases on which further active collections actions were unlikely to yield
2 recovery. These were treated differently for accounting purposes depending on whether the lease
3 was retained by PSL or its payment stream was sold to an Investor Bank.

4 **9.7.1 Sold-Lease Pay-Offs.** At PSL, Steve Twidwell (Senior Vice President
5 and manager of the customer service and collections departments) generally made the decision to
6 remove a lease from the system and pay-off the Investor Bank because the likelihood of recovery
7 was no longer worth the cost and efforts of active collections. Generally, when this decision was
8 made PSL would inform the Investor Bank and calculate the present value of all future payments
9 due to the Investor Bank under that payment stream. Then, the next month, when the Investor
10 Bank was scheduled to ordinarily receive a monthly payment, it would instead receive the pay-
11 off based on the present value of the future payment stream (a “Sold Lease Pay-Off”). This was
12 the second half of PSL’s No Loss Practice. For PSL, these losses were not subject to any unique
13 accounting treatment as they were simply deducted from PSL’s earnings during the relevant
14 period as any amounts paid under its No Loss Practice. PSL could slightly delay making a
15 present value pay-off to an Investor Bank when PSL had charged off a lease under its No Loss
16 Policy; and instead, for cash flow management purposes, would simply continue to forward
17 monthly payments to the Investor Bank. In that situation, a monthly payment would be posted in
18 PSL’s lease management system and there would be a miniscule impact on PSL’s delinquency
19 rate for the month the payment was applied.

20 **9.7.2 Owned Lease Charge-Offs.** Where the lease being removed from the
21 system was a lease owned by PSL, the lease would simply be removed from the system, and PSL
22 would have to show the remaining amounts due as a loss for accounting purposes (an “Owned
23 Lease Charge-Off”). For 2006, this amount was \$229,000. See Gould Declaration, Docket 12,
24 Ex. A, pp. 7-35. PSL sold to FSB no owned leases, nor any Sold Leases which it was servicing,
25 which at the time of closing, required any charge-offs. This was the purpose of the post-closing
26 settlement check sent by Larasco to FSB for \$446,332.31.

1 **10. PSL’S TRANSITION OF ITS LEASE MANAGEMENT AND ACCOUNTING**
2 **SYSTEM TO INFOLEASE**

3 **10.1 PSL’s Choice to Convert to InfoLease.** In early 2007, PSL began its own due
4 diligence to determine how to shift its leasing and accounting management to another system.
5 Although we had spent years formulating our own accounting an reporting system to ensure we
6 had extraordinarily robust tracking and reporting capability, we realized that whether we sold our
7 assets to a bank or formed our own bank, we needed an updated and industry-accepted
8 accounting system. Ultimately, PSL engaged Information Decision Systems (“IDS”) of
9 Minneapolis, Minnesota to customize its InfoLease system to PSL’s needs. IDS had customized
10 InfoLease for many major bank leasing subsidiaries in the industry, including Wells Fargo,
11 LEAF Financial, and US Bank.

12 **10.2 Conversion Process.** The conversion to InfoLease began in May of 2007 and
13 was not completed until November 1, 2007. Anyone familiar with system conversions of this
14 size would be aware that it often takes 12-18 months to work out the errors, bugs, and other
15 artifacts of transitioning information and reporting of this magnitude from one system to another.
16 As a result, when Mr. Shaughnessy confronted me about the increase in the delinquency rate, as
17 calculated by InfoLease, I became concerned that the conversion was generating some
18 inaccuracies in the data being reported. I never made any assurances to FSB that the conversion
19 to InfoLease would be without difficulties, but I anticipated that with the experience of IDS and
20 FSB’s own knowledge of the regulatory requirements upon it, the new InfoLease system would
21 soon be capable of meeting everyone’s expectations.

22 **10.3 Challenges of Converting to InfoLease.** One of the significant challenges we
23 faced with the conversion to InfoLease was its extremely low tolerances. InfoLease generally
24 showed a number of leases to be delinquent which in fact were not. Under the InfoLease system
25 if a payment was \$0.01 short, or was received on a Saturday at the end of the month, but not
26 deposited and posted until Monday, the lease would show in InfoLease as delinquent. In
addition, if sales tax was raised in a far-flung jurisdiction where lease equipment was located,

1 and the lessee mistakenly sent its monthly payment based on the old sales tax rate, the lease
2 would show up in InfoLease as past due. Under our prior system, the customer could generally
3 be called, the mistake corrected, the difference remitted, and the account placed in good
4 standing. InfoLease artificially increased the Delinquency Rate by showing these accounts with
5 nominal amounts due as delinquent. InfoLease exacerbated this problem through its inability to
6 easily generate collections information. This hindered PSL's ability to quickly and easily
7 identify the source of the delinquency and make the appropriate collections calls to remedy the
8 delinquency. For these reasons and others, I felt InfoLease's reported delinquency rate of 2.54%
9 in November of 2007 was not accurate. My assessment was confirmed in the Stratton Report
10 described in ¶ 8.7.2, above.

11 **11. PSL'S TREATMENT OF SECURITY DEPOSITS**

12 **11.1 Initial Collection and Treatment of Security Deposits**

13 **11.1.1** PSL required lessees to place with PSL a security deposit in the amount
14 generally equal to two months' lease payments. The treatment of these amounts was governed
15 solely by the terms of the lease agreements. See Docket 17-2, p.70. PSL's leases generally
16 provided language similar to the following:

17 "7. SECURITY. As security for prompt and full payment of rent, and the
18 faithful and timely performance of all provisions of this Lease, and any extension
19 or renewal thereof, Lessee has pledged and deposited with Lessor the security
20 amount set forth in the section shown as 'TERMS'. In the event any default shall
21 be made in the performance of any of Lessee's obligations under this Lease,
22 Lessor shall have the right, but shall not be obligated to apply said security to the
23 curing of such default. Upon notice that Lessor has applied any portion of the
24 security to the curing of any default Lessee shall, within ten (10) days, restore said
25 security to the full amount set forth above. On the expiration or earlier
26 termination of this Lease, or any extension or renewal hereof, provided Lessee has
paid all of the rent herein called for and fully performed all of the other provisions
of this Lease, Lessor will return to Lessee any then remaining balance of said
security. Lessor shall not be required to keep the security deposit separate from
its general funds and Lessee shall not be entitled to any interest thereon."

See Docket 17-2, p.70.

1 **11.1.2** I did not refer to lessee’s security deposits as “our money.” I likely
2 explained to clerical employees, like Ms. Wright and Ms. St. Pierre, in the event a lessee failed to
3 make a payment or otherwise owed to PSL funds under its lease agreement, PSL would pay from
4 its own revenues the amounts due to Investor Banks, or for personal property taxes, sales taxes,
5 and insurance premiums, even where PSL had not yet received those amounts from the lessees.
6 Each month, PSL would then appropriately apply lessees’ security deposits to these amounts due
7 and owing.

8 **11.1.3** Under the terms of the lease, PSL had the right to apply security deposits
9 to delinquent payments and to a number of other owing costs and fees. The terms of the lease do
10 not require notification to the lessee of forfeiture; however, PSL would often inform customers
11 of forfeitures and inform them that under the terms of the lease they had 10 days to replenish the
12 deposit amount, otherwise they would be in default of the lease and recovery procedures would
13 commence, including but not limited to the repossession and sale of the leased equipment.

14 **11.2 Accounting of Security Deposits**

15 **11.2.1** With respect to the accounting of these leases for purpose of PSL’s
16 Delinquency Rate, where the security deposit was applied per Section 7 of the lease to a past due
17 payment, the lease would appear current because in fact, it was current. By definition, if all
18 amounts due and owing under the lease term had been collected by PSL, the lease was current.
19 The issue of replenishing the security deposit was distinct and separate from delinquency.

20 **11.2.2 Forfeiture of Security Deposits was Not Revenue Related to SOLD**
21 **Leases.** This practice did not result in increased revenue on the Sold Lease Portfolio purchased
22 by FSB because there was no revenue recognized on sold leases after the date of sale. Such
23 accounting would be in violation of GAAP. PSL was the servicer of these leases and was
24 entitled to residuals under the terms of the Program Agreements with the Investor Banks, but no
25 revenue from the lease payments themselves.
26

1 **11.2.3 Forfeiture of Security Deposits was Income Related to HELD Leases.**

2 In the case of owned or Held Leases, PSL applied all amounts collected from the application of
3 security deposits to income, because such application is proper under GAAP. This practice was
4 approved by FSB’s own auditor and confirmed by FSB’s CFO, Ms. Gould. Attached as **Exhibit**
5 **M** is a true and correct copy of an October 23, 2008 email Ms. Gould then forwarded to myself,
6 Mr. Blair, Mr. Shaughnessy, and Mr. Hirtzel, confirming this practice was appropriate (the “Ms.
7 Gould’s Security Deposit Forfeiture Email”). Ms. Gould originally queried Christie Baker of
8 McGladrey on October 20, 2008:

9 “I just wanted to confirm that there will not be a problem with the security
10 deposit forfeiture income. When we discussed it earlier, you indicated that
11 PSL has a right to take this into income. This is a large number in our
12 income statement so this is important to us. Please let me know if there are
13 concerns regarding this.”

14 Ms. Baker then replied to Ms. Gould on October 21, 2008, indicating that while
15 this process was acceptable for PSL, it may be different for FSB, and FSB would have to provide
16 support for its taking of these amounts as income. Ms. Baker wrote:

17 “We will be requesting that you provide support for recognizing this. Our
18 research at PSL did support them doing this based upon the language in
19 the contracts. We will need to verify the language has not changed. We
20 do audit that the lease is delinquent at the time recognized and that it was a
21 lease acquired by you versus one that PSL retained servicing on. I don’t
22 remember all of the specifics right now but I think we also verified that the
23 lessee was also billed the following month to replenish the security
24 deposit. If you could provide support on an individual lease basis that the
25 lease was acquired by the bank – we will need that to select our sample for
26 testing.”

 Ms. Gould then informed us that I was to make selections of the deposits to be
forfeited and she herself would approve them. Ms. Gould wrote,

 “ We need to make sure the forfeitures are in line with these rules. The best
method is to make your selection and have a one over one review and signoff. I
can come over and do it next week for this month.”

11.3 Review and Forfeiture of Security Deposits

1 **11.3.1 The Security Deposit Analysis.** On a regular basis, I would review the
2 entire lease portfolio, both owned and sold, to determine whether individual leases were in
3 default per the terms of the lease agreements. Numerous reports were used to determine this in
4 our old accounting system, but InfoLease produced one massive report titled the “Security
5 Deposit Analysis” (“SDA”) which often exceeded 200 pages. A true and correct copy of pages
6 1-5 of the SDA for June 2008 is attached as **Exhibit N**. A true and correct copy of pages 1-5 of
7 the SDA for October 2008 is attached as **Exhibit O**.

8 **11.3.2 Review.** Generally, when reviewing the SDA or its predecessors, I would
9 mark those leases which the reports confirmed were in sufficient default to warrant the forfeiture
10 of the security deposit and application to amounts outstanding.

11 **11.3.3 Many Methods of Default Triggered Forfeiture.** Delinquency is not the
12 only form of default criteria triggering forfeiture of a security deposit under the lease agreement.
13 Other events of default include failing to pay interim rent, personal property taxes, insurance
14 premiums, business and occupation taxes, or even moving the equipment without providing PSL
15 notice. The SDA documents each of these factors for every lease and identifies if and why a
16 lease was in default.

17 **11.3.4 Ms. Wright and Ms. St. Pierre** were not instructed to cause the accounting
18 system to forfeit the selected deposits and credit PSL’s income for these amounts. Ms. Wright
19 and Ms. St. Pierre fail to understand fundamental accounting principles, let alone GAAP.

20 **11.3.5 My brother and I** legitimately enforced PSL lease agreements and never
21 improperly forfeited or improperly retained security deposits. Ms. Kady has no basis for her
22 statement. She had no knowledge or understanding of PSL’s security deposit practices, as these
23 practices were not part of her duties.

24 **11.4 Security Deposit Treatment by FSB**

25 **11.4.1 FSB and Ms. Gould’s Forfeiture Goals.** After the Asset Sale, Ms.
26 Gould would communicate to me, often multiple times each month, a specific dollar amount or

1 “goal” of security deposits she desired to have the leasing division flow into FSB’s revenues. I
2 would then, at Ms. Gould’s direction, review the SDA and mark those security deposit amounts
3 which could be forfeited under the lease terms, up to the amount requested by Ms. Gould. From
4 the period of March 1, 2008 to June 30, 2008, the forfeitures requested by Ms. Gould totaled
5 \$1.4 million, approximately \$311,900 in March, \$150,000 in May, and \$910,000 in June. This
6 practice was demanded by Ms. Gould to “smooth out earnings” for FSB’s reporting purposes.
7 Attached as **Exhibit P** is an e-mail of October 23, 2008, from Ms. Gould to myself, Mr.
8 Shaughnessy, Mr. Hirtzel, and Doug Blair, in which Ms. Gould states, “Month to date, we have
9 taken \$221,742 in income. I think that is adequate for now and let’s see how October income
10 looks. We can do more in November or December if need be.”

11 **11.4.2 Ms. Gould’s Forfeiture Projections.** Ms. Gould herself projected that
12 these amounts would be approximately \$150,000 per month for the final quarter of 2008.
13 Attached as **Exhibit Q** is a true and correct copy of FSB’s Income Statement and Balance Sheet
14 by Month (including PSL) for 2008, with actual numbers through September and Ms. Gould’s
15 projections for October through December (the “Income Statement and Balance Sheet by
16 Month”).

17 **11.4.3 FSB Confirmed this Practice was Lawful and Appropriate.** Not only
18 did FSB know of this practice, Ms. Gould even confirmed with its auditor, McGladrey, that
19 PSL’s treatment of security deposits was an appropriate practice. See Ms. Gould’s Security
20 Deposit Forfeiture Email (**Exhibit M**).

21 **12. RESIDUAL SHARING AGREEMENTS**

22 **12.1** During the lease negotiation process, PSL’s lease brokers would use a series of
23 charts to negotiate with lessees the terms of the lease including the rate and the residual amount.
24 Attached as **Exhibit R** is a true and correct copy of PSL’s rate and residual pricing matrix as
25 revised on October 2, 2008.

1 **12.2 Common Practice.** For a short period of time, PSL provided its brokers with the
2 flexibility to enter into residual sharing agreements. PSL has never denied the existence of these
3 residual sharing agreements, as they are common practice in the leasing industry.

4 **12.3 Additional Compensation for Brokers.** Residual sharing agreements enabled
5 brokers to quote customers whose lease terms would ordinarily end in a nominal residual of \$1, a
6 larger residual purchase price. If the broker was successful in negotiating this larger residual, a
7 secondary agreement was entered into between the broker and PSL providing for the sharing of
8 this surplus amount, if and when it was paid. This was a convenient method for brokers to earn
9 additional commission-like compensation.

10 **12.4 Post-Booking Residual Sharing Agreements Approved by John Olah.**

11 Problems arose when some leases were entered in the lease management and accounting system
12 with a \$1 residual, and brokers later submitted to John Olah a residual sharing agreement. Mr.
13 Olah authorized these agreements and kept these unrecorded and unagreed-upon residual sharing
14 agreements in his desk, and no one else at PSL would know about them. These residual sharing
15 agreements were now separate from the lease file and unknown to PSL. Because the lease
16 management and accounting system only showed the \$1 residual, this amount would be used to
17 settle the lease at the end of its term. As a result, after collecting the \$1 residuals booked on the
18 system from the lessee, brokers would contact PSL seeking payment of the residual amount in
19 the residual sharing agreement that was signed by John Olah. This improper conduct was one of
20 the many reasons John Olah was demoted from his position as Broker Manager. Despite Mr.
21 Olah's improper conduct, and in an effort to maintain a positive relationship with brokers
22 throughout the country, PSL often honored some of these agreements and paid the brokers. This
23 improper conduct was one of the many reasons Mr. Olah was demoted from his position as
24 Broker Manager at PSL. There were likely only a small number of such agreements out of the
25 tens of thousands of leases PSL has booked, sold, and/or serviced over its 23 year history.
26

1 **12.5 FSB’s Contra-Asset Account Was Used to Protect its Balance Sheet.** It was
2 not PSL’s practice to increase the amount of residuals in put letters. After its purchase of PSL,
3 however, FSB, through Ms. Gould, sought additional revenue from the leasing division and
4 discussed this issue with Christy Baker of FSB’s and PSL’s own auditor, McGladrey. Ms. Baker
5 informed Ms. Gould that FSB could increase the amount of the residuals per the terms of the
6 agreement and Put-Rider, but FSB could not recognize revenue for these amounts until and
7 unless they were paid by the lessee at the end of the lease. To ensure that these amounts
8 appeared only as revenue, and never as losses, Ms. Gould set up a unique accounting convention
9 at FSB called a contra-asset account. The contra-asset account was not reflected on FSB’s
10 balance sheet, and allowed FSB to track these increased residuals and claim as income only if
11 collected, while insulating FSB from having to claim them as losses if they were not collected.

12 **13. LEASE EXTENSIONS**

13 **13.1 Common Practice.** Extensions of time are commonly granted by all financial
14 services providers, but were rarely granted by PSL. Often finance companies give customers
15 additional time to pay or refinance the terms of their obligations so as to ensure continued
16 payment and a positive relationship with their customers. On rare occasions when customers
17 requested additional time to pay in response to temporary or unforeseeable financial difficulties,
18 PSL would consider granting them a lease extension. For example, if a lessee was in the hospital
19 or had to make an exceptional tax payment, PSL would work with them to extend their lease
20 agreement to ensure future and full payments. Regardless, however, even during such periods,
21 PSL honored its No Loss Practice and paid Investor Banks timely and in full.

22 **13.2 Oversight and Process.** Senior Vice President Steve Twidwell, oversaw this
23 process. If he determined the lessee’s difficulties where an appropriate circumstance for
24 extending a lease, he would prepare a lease extension agreement and fax it to the lessee for
25 execution. I never instructed Jennifer Wright to add delinquent payments to the end of a lease.

1 **13.3 Effect of Terms.** Any lease extension would simply add payment dates to the
2 end of the lease and provide for an extension fee payable to PSL in consideration of the
3 extension. This generated a small amount of additional revenue for PSL.

4 **13.4 Extensions Granted to PSL/FSB Employees.** For certain employees, and in
5 limited circumstances, PSL would provide financing for employee purchases. For Ms. Kady,
6 PSL financed at least one vehicle, as well as a washer and dryer when Sears would not approve
7 her for financing. For Ms. Wright, PSL financed several vehicles over the course of her
8 employment. For Ms. St. Pierre, PSL also financed at least one vehicle. Ms. Wright and Ms. St.
9 Pierre often were unable to make their payments and would often ask for extensions of their
10 lease terms. Their requests were granted every time they asked.

11 **14. THERE ARE NO SECORD FAMILY TRUSTS**

12 **14.1** In recent years, my brother and I have considered various methods of tax and
13 estate planning for ourselves and our families. It was once suggested that we establish family
14 trusts in order to take advantage of their lawful tax and estate planning benefits.

15 **14.2** To this date, no personal or family trusts were ever pursued or established by me
16 or my brother.

17 **15. CLARIFICATION AGREEMENT**

18 **15.1** In July 2008, Mr. Hirtzel and Mr. Shaughnessy met with me and my brother to
19 discuss the fact that FSB was struggling and FSB needed me and my brother to take on
20 significantly more of the financial burden of losses of the FSB Leasing Division than was agreed
21 under the APA. Mr. Hirtzel expressed that if we did not sign an agreement confirming our
22 willingness to take on these additional burdens, FSB would not meet its earnings projections for
23 the second quarter of 2008 as Mr. Hirtzel had promised shareholders and others and all FSB
24 shareholders, including my brother and I, would suffer as a result.

25 **15.2** In the July 2008 meeting, Mr. Hirtzel and Mr. Shaughnessy proposed a document
26 that he said would confirm these additional burdens and informed us that FSB's counsel was

1 drafting it. Mr. Hirtzel and Mr. Shaughnessy made it clear that we must sign the undisclosed
2 document right away “or else.” Mr. Hirtzel and Mr. Shaughnessy stressed the importance that
3 this happen quickly because FSB’s quarterly earnings report was due and this was the only item
4 holding up issuance of the report. Because of our roles as an employee and consultant of FSB,
5 we had little doubt that the “or else” tone of the meeting meant, at least in part, that our
6 continuing roles with the FSB Leasing Division would be in jeopardy if we did not sign right
7 away.

8 **15.3** Shortly after the initial meeting, we were presented with a document entitled
9 “Agreement to Clarify Operating Procedures” (the “Clarification Agreement”). Mr. Hirtzel and
10 Mr. Shaughnessy did not allow us any reasonable time to review the Clarification Agreement.

11 **15.4** The Clarification Agreement again confirmed that FSB would continue the No
12 Loss Practice. The Clarification Agreement states in pertinent part: “The parties agree that even
13 though the leases sold are sold on a “non-recourse basis” it is in the best interest of the parties
14 that [FSB] continues the practice adopted and implemented by [PSL] of reimbursing investors
15 for any losses in portfolios they purchase.” Clarification Agreement, Paragraph 3. A copy of the
16 Clarification Agreement is attached as **Exhibit S**.

17 **15.5** In addition to reassurances that the No Loss Practice would continue, Mr. Hirtzel
18 and Mr. Shaughnessy also reassured us in the July 2008 meeting that FSB supported us in
19 running the FSB Leasing Division. Mr. Hirtzel and Mr. Shaughnessy emphasized that we would
20 do so well financially over the six-year earn-out that we should not worry about taking on the
21 additional financial burdens in the Clarification Agreement.

22 **15.6** In reaction to the threatening tones employed in the meeting and the written and
23 verbal representations by FSB, Mr. Hirtzel, and Mr. Shaughnessy related to the Clarification
24 Agreement and intending a long-term relationship despite the threats, we signed the Clarification
25 Agreement as requested. We signed the Clarification Agreement in the office of FSB’s counsel
26 within hours of first seeing the document. Mr. Hirtzel and Mr. Shaughnessy and FSB’s counsel

1 reassured us that the Clarification Agreement was in everyone's best interest and urged us to just
2 sign it.

3 **15.7** FSB has yet to provide us with a calculation of amounts alleged by FSB to be due
4 under the Clarification Agreement.

5 **16. FSB'S QUICK PROFIT AND THEN SYSTEMATIC DESTRUCTION OF A**
6 **SUCCESSFUL LEASING BUSINESS**

7 **16.1 PSL Held Saleable Assets to Ensure FSB Could Post an Immediate Profit**
8 **After Closing.** Once PSL agreed to the APA, PSL retained lease portfolios it would have
9 otherwise sold and profited from. We did this so that following the Closing Date, FSB would
10 have a number of pre-packaged lease portfolios ready to sell immediately. This was in fact the
11 case. By looking at the September 30, 2008 calculation of the Larasco earn-out, in the seven
12 months following the Closing Date, FSB realized a gain on the sale of leases in the amount of
13 \$3,500,200. Attached as **Exhibit T** is a true and correct copy of FSB's Calculation of Larasco
14 Earn-out for the Period Ended September 30, 2008 (the "Larasco Earn-Out"). We could have
15 enriched ourselves exclusively by selling these portfolios to other Investor Banks in the normal
16 course of PSL's business prior to the Asset Sale, however, we told FSB we would hold on to
17 these leases to allow FSB to make an immediate profit from the sale of these leases shortly after
18 the Closing Date. In the interest of continuing to build a long-term, mutually beneficial
19 relationship with FSB, we honored this commitment to our detriment and to the benefit of FSB.

20 **16.2 PSL's Instant Positive Impact on FSB.** As of September 30, 2008, FSB's net
21 income from the new PSL leasing division in its first seven months, prior to our payout, was
22 \$3,132,400. This was after the PSL leasing division set aside \$1,316,000 for loan loss reserves.
23 Essentially, FSB was returned almost its entire cash purchase price of \$4.5 million within months
24 of the Closing Date. As of September 30, 2008, FSB's year to date cumulative earnings were
25 only \$1,349,000. See 2008 Income Statement and Balance Sheet by Month (**Exhibit Q**).
26 Without the instant contribution of the leasing division and its performance over the seven
months between the Closing Date and October 2008, FSB would have otherwise shown a loss of

1 \$1.8 million, year to date, and would not have had the benefits of an additional \$1,316,000 in
2 loan loss reserves contributed by the PSL leasing division.

3 **16.3 FSB's Ill-Advised Closing of the Recovery Department Increased its Own**
4 **Losses.** Shortly thereafter, in October of 2008, FSB closed the recovery department of PSL to
5 reduce overhead. It was clear that FSB failed to understand that by doing so, it may have been
6 cutting costs immediately, but was eliminating its ability to reduce future losses on defaulted and
7 charged-off leases. One of PSL's strengths was its collections and recovery department. This
8 department was a key component to PSL's success over the course of its 23 year history because
9 while recoveries did not generate revenue, they allowed PSL to significantly mitigate its losses.
10 FSB's abandonment of the recovery department only exacerbated its losses.

11 **16.4 FSB's Ill Advised Shut Down of Legal Actions Increased its Own Losses.**
12 Also in October 2008, FSB instructed corporate counsel Rob Lloyd to inform local counsel
13 throughout the country to discontinue all legal actions until further notice. This has only recently
14 resumed, and only on FSB's portfolio of held leases, not on the serviced leases. FSB has
15 mandated that collection actions on the serviced leases will only continue if the Investor Banks
16 agree to pay collections counsel directly. PSL had always provided these services at no cost to
17 Investor Banks and systematically recovered these costs from the sale of equipment or by
18 collecting judgments.

19 **17. THE UNFORTUNATE TIMING OF FSB'S PURCHASE OF PSL**

20 **17.1** In September of 2007, our diverse and well managed leasing business had yet to
21 suffer from the economic difficulties facing many others.

22 **17.2 Accessibility to Credit Aided PSL's Growth and Profitability.** During 2003-
23 2007 our business flourished in large part because our customers had easy and inexpensive
24 access to credit. This enabled lessees to keep up with their payments to PSL by borrowing
25 money from friends, families, banks, and by easily obtaining credit cards, home equity lines of
26 credit or through refinancing their homes. Also during this time, the personal guaranties that we

1 had obtained in years past started to yield tremendous revenue. This occurred because former
2 lessees sought to refinance their homes, but in order to do so they would have to pay off amounts
3 owing to PSL in order to have PSL's liens removed. There was also a very strong market for
4 equipment re-sale during this time frame which allowed PSL to achieve greater recovery on
5 repossessed goods.

6 **17.3 Freezing of Credit Markets Harmed the Leading Industry.** The economy
7 changed shortly after the APA was signed and this has been the greatest source of loss for FSB.
8 The loss of credit availability has greatly reduced lessees' access to alternative forms of cash and
9 credit to pay their leases. The amount of businesses failing has dramatically increased and this in
10 turn drives up delinquency rates and charge-offs. Receivable delinquencies of all kinds are
11 increasing and aging like never before. The extent of this problem is only overshadowed by how
12 quickly this happened.

13 **18. PSL STILL REMAINS ONE OF FSB'S BEST PERFORMING ASSETS**

14 **18.1** Attached as Exhibit U is a true and correct copy of FSB's February 6, 2009 year
15 end press release for 2008 (the "2008 Year End Press Release"). According to this press release,
16 as of December 31, 2008, FSB had loans of \$219 million with leases of approximately \$46
17 million. 2008 Year End Press Release (Exhibit U); 2008 Income Statement and Balance Sheet
18 by Month (Exhibit Q). Of FSB's \$275.7 million in total assets, 3.8% or \$10.5 million, were
19 identified as non-performing because they were over 90 days past due. Of these non-performing
20 assets, 88.5% were real estate construction loans (a total of \$9.3 million), while only 11.5% were
21 small-ticket leases (a total of \$1.2 million).

22 **18.2** As of September 30, 2008, FSB had approximately \$215 million in net loans,
23 approximately \$76 million were real estate loans and \$47 million were leases. Thus, over
24 12.2% of FSB's \$76 million of real estate loans were non-performing at this time, while only
25 2.55% of its \$47 million of leases had reached this status. See 2008 Income Statement and
26 Balance Sheet by Month (Exhibit Q).

1 **19. NEITHER PSL NOR MY BROTHER AND I HAVE ENGAGED IN**
2 **DISCRIMINATORY LENDING OR EMPLOYMENT PRACTICES.**

3 **19.1** I read with great sadness the allegations of two of the approximately 65 former
4 employees of PSL that my brother and I engaged in discriminatory hiring and lending practices.
5 It is ironic that the two former employees making these allegations are women, and two of the
6 leases attached to FSB's Motion materials reflect leases made to women-owned or managed
7 businesses. I do not know, and FSB has not produced, the basis for these allegations, but our 23
8 year record readily refutes these allegations. I look forward to clearing my and my brother's
9 names of these allegations and FSB's equally baseless and shocking fraud allegations in the
10 course of this litigation.

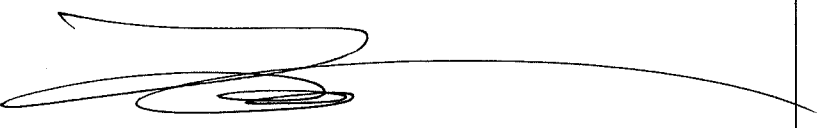
11 **20. NET WORTH**

12 My net worth at the time of the Asset Sale was significantly greater than it is today. Over
13 the past year, FSB stock has fallen from \$14 per share to \$3 per share at the time this declaration
14 was signed, effectively reducing my net worth by over \$3 million. My share of the estimated
15 value of the earn-out was \$6-7 million. This amount is worthless in light of FSB's destruction of
16 the PSL leasing division. Because FSB has refused to honor my five-year, \$500,000 per year
17 employment contract, I have no source of income. This loss also represents a \$2.5 million-dollar
18 decline in my net worth. The values of my other assets have also declined significantly over the
19 past year, including the value of my real estate, equities, 401(k), and IRA (all FSB stock).

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I DECLARE UNDER PENALTY OF PERJURY UNDER THE LAWS OF THE STATE OF WASHINGTON THAT THE FOREGOING IS TRUE AND CORRECT.

Dated this 2nd day of March, 2009 at Seattle, Washington.



Louis A. Secord, Jr.

1 **Certificate of Service**

2 I certify that on the date noted below, I electronically filed this document entitled
3 Declaration of Louis A. Secord, Jr. in Support of Defendants' Response to First Sound Bank's
4 Motion for Writ of Attachment and Preliminary Injunction Freezing Assets using the CM/ECF
5 system which will send notification of such filing to the following persons.

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7 C. Seth Wilkinson
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14 DATED this 2nd day of March, 2009, at Seattle, Washington.

15 /s/ Diana S. Shukis

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