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Court of Appeals No. 47716-5-II

Trial Court No. 12-2-02882-0

COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION TWO

ALEX SAFRANSKI,

Appellant,

v.

SULTAN WEATHERSPOON,

Respondent.

RESPONDENT SULTAN WEATHERSPOON'S PETITION FOR REVIEW

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TABLE OF CONTENTS

Page

Table of Authorities ii

I. IDENTITY OF MOVING PARTY 1

II. THE COURT OF APPEALS DECISION 1

III. GROUNDS FOR REVIEW 1

IV. ISSUES PRESENTED FOR REVIEW 1

A. Shareholder Standing Is an Issue of First Impression. 1

B. Alternatively, the Trial Court's Denial of a Motion for Summary Judgment Was Not Reviewable. 3

V. STATEMENT OF THE CASE 3

A. The Fraud 3

B. The Trial Court Proceedings 6

C. Safranski's Appeal 8

D. Conflicting Interpretation of Two Exceptions 13

(1) Special Duty Exception. 13

(2) Distinct Harm Exception. 14

E. Another Common Law Exception Not Considered 16

F. Why Review Should Be Accepted 17

VI. TRIAL COURT DECISION WAS NOT REVIEWABLE 18

VII. CONCLUSION 20

Appendix 25

TABLE OF AUTHORITIES

Cases

Adcox v. Children's Orthopedic Hospital and Medical Center,
123 Wn.2d 15, 864 P.2d 921 (1993) 18

Favors v. Matzka,
53 Wn. App. 789, 770 P.2d 686 (1989) 7

Hunter v. Knight, Vale & Gregory,
18 Wn. App. 640, 571 P.2d 212 (1977) 9, 10, 11

Johnson v. Rothstein,
52 Wn. App. 303, 759 P2d 471 (1988) 18

Sabey v. Howard Johnson & Co.,
101 Wn. App. 575, 5 P.3d 730 (2000) ..... passim

Univ. Vill. Ltd. Partners v. King County,
106 Wn. App. 321, 324, 23 P.3d 1090 (2001) 18

Other Authorities

12B William Meade Fletcher, Cyclopedia of the Law of Corporations ... 11

12B William Meade Fletcher, Cyclopedia of the Law of Corporations, §5911.5 17

12B William Meade Fletcher, Cyclopedia of the Law of Corporations, §5915 11

19 *Am. Jur. 2d Corporations* §1955 (2004)..... 11

19 *Am. Jur. 2d Corporations* §1956 (2004)..... 16

Rules

CR 17(a)..... 8

CR 50 ..... 7, 8, 19

RAP 2.3..... 20

I. IDENTITY OF MOVING PARTY

Respondent Sultan Weatherspoon ("Weatherspoon").

II. THE COURT OF APPEALS DECISION

Weatherspoon seeks discretionary review of the Court of Appeals' (Division II) Opinion filed on January 24, 2017 reversing the trial court's denial of a summary judgment motion filed by Appellant Alex Safranski ("Safranski"). **Appendix A**. On April 12, 2017, the Court of Appeals denied Weatherspoon's Motion for Reconsideration and Motion to Publish its Decision. **Appendix B**.

III. GROUNDS FOR REVIEW

The issues raised are of substantial public importance due to the number and importance of closely-held corporations in Washington state, and the likelihood that a similar fact pattern will arise. Further, the case presents questions of first impression to this Court, and the Court of Appeals' Opinion conflicts with another Court of Appeals opinion.

IV. ISSUES PRESENTED FOR REVIEW

A. Shareholder Standing Is an Issue of First Impression.

Weatherspoon requests this Court to examine, for the first time, whether a direct shareholder-to-shareholder claim for fraud is actionable, particularly when the fraud extinguishes the corporation's right to sue.

The trial court found that Weatherspoon had standing to sue, but the Court of Appeals disagreed. Both courts interpreted differently a case decided seventeen years ago by Division One of the Court of Appeals, *Sabey v. Howard Johnson & Co.*[1]

The Court of Appeals rested its decision on a distinction between two types of transactions commonly used to buy and sell closely-held corporations. At oral argument, Safranski conceded, as he must, that Weatherspoon would have standing had the fraudulently-induced transaction been structured as a stock sale.

> THE COURT: Let's say that Mr. Weatherspoon actually sold his stock to BMS; right? Now that he has lost majority control, now he has lost his stock, would there be an action there?
>
> MR. TURNER: Yes.[2]

Safranski argued, however, that because the transaction was an asset sale, Weatherspoon cannot sue him.[3] The Court of Appeals erroneously agreed.

Safranski does not quarrel with the trial court's ruling that he owed fiduciary duties to Weatherspoon at the time of his fraud. He does not dispute he fraudulently induced Weatherspoon to sell all of Duma's assets,

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[1] 101 Wn. App. 575, 5 P.3d 730 (2000).
[2] Appendix C, p.5.
[3] A basic practitioner's guide explaining the differences between an asset sale transaction and a stock transaction is set forth in Appendix D.

and that the transaction extinguished Duma's right to sue Safranski for his fraud. If Weatherspoon has no standing, the victim of the fraud has no remedy, and the fraud-doer has no legal liability. That result wholly contradicts the law in other jurisdictions, and the Court of Appeals decision in *Sabey*. It also deeply offends the basic premise and public policy underlying the standing requirement. This is a clear and compelling case for review.

B. Alternatively, the Trial Court's Denial of a Motion for Summary Judgment Was Not Reviewable.

The Court of Appeals overturned a trial court decision denying Safranski's motion for summary judgment on factual grounds. That decision was not reviewable.

V. STATEMENT OF THE CASE

On March 31, 2015, a jury found that Safranski had defrauded Weatherspoon and awarded $275,637.50 in fraud damages.[4]

A. The Fraud

Duma Video, Inc. ("Duma") was a small privately held corporation in Vancouver, Washington. Weatherspoon owned 79.31% of Duma's stock, and Safranski owned 20.69%.[5] Until a few months before Duma

[4] CP 384-5.
[5] CP 466.

sold its assets in 2012, Safranski was employed by Duma as a software engineer.

Duma developed, sold and licensed products that compressed video used to transmit video from a camera to a remote receiver. Duma's products involved "encoders" (software used on the camera end), and "decoders" (hardware used on the receiver end). Its largest customer was Broadcast Microwave Services, Inc. ("BMS").

In 2012, due to various disputes between Weatherspoon and Safranski, the two shareholders decided to sell Duma.[6] BMS expressed interest in buying Duma, but BMS wanted Safranski to become employed by BMS as part of the sale transaction.

As the negotiations proceeded, Safranski quit his employment with Duma. Safranski told Weatherspoon he was going to work for a different company. Weatherspoon informed BMS that because Safranski would not become employed by BMS, the negotiations were terminated.

BMS then revived the negotiations with Weatherspoon, informing him that Safranski's employment was no longer a requirement. Weatherspoon concluded the negotiations with BMS, and Duma executed an Asset Purchase Agreement ("APA") prepared by BMS.

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[6] Safranski did not provide the Court of Appeals with a transcript of the trial or the trial exhibits and he does not challenge the sufficiency of the evidence. The summary below is not disputed by Safranski, and the Court of Appeals also summarized the fraud. Opinion at p.2.

Under the APA, Duma transferred all of its assets to BMS, including all of its intellectual property, some of which had been patented. The term "Assets" was defined in the APA to include any causes of action that Duma may have owned at the time of the transaction.

BMS agreed to pay a purchase price of $1,250,000 for Duma's assets. However, one of Duma's assets – an H.264 decoder – was still in development phase when the APA was executed. Because the H.264 decoder was not a finished product, BMS held back $350,000 from the purchase price under an "Earn Out" provision. Under this provision, BMS would pay the remainder of the purchase price when and if Duma completed the development of the H.264 decoder.

BMS reserved its right to determine whether the H.264 decoder was acceptable to BMS – a risk that Weatherspoon accepted because he believed that Duma's proprietary code and other IP was essential to the H.264 decoder. He did not believe BMS could obtain the H.264 decoder from any other source.

What Weatherspoon did not know is that after Safranski quit Duma, he did not go to work for another company, as he had represented. Instead, without Weatherspoon's knowledge, Safranski contracted with BMS, agreeing to build a decoder for BMS substantially identical to the H.264 decoder Duma would build for BMS. Safranski agreed to be paid

$160,000 for delivering his decoder, a price that was much less than the amount of $350,000 that BMS would pay Duma for the same decoder under the APA's Earn Out provision.

In 2013, Weatherspoon delivered the H.264 decoder to BMS, but BMS rejected that decoder as deficient over Weatherspoon's objection. Without Weatherspoon's knowledge, Safranski delivered his decoder to BMS and was paid $160,000.

B. The Trial Court Proceedings

Safranski sued Duma and Weatherspoon first, alleging a wage claim, and both a personal and a derivative claim in Duma's name seeking to recover his percentage of expense reimbursements Duma had paid to Weatherspoon.[7]

Weatherspoon and Duma filed separate fraud counterclaims against Safranski based on the concealment of the $160,000 bonus arrangement.[8]

Both sides filed motions for summary judgment relating to the claims and counterclaims made by Duma against each other.[9] Both sides argued successfully that those claims asserted by Duma should be dismissed because all of Duma's claims were transferred to BMS under

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[7] CP 001-015.
[8] CP 132.
[9] CP 052 and CP 073.

the APA's broad definition of "Assets." The trial court disagreed with Duma's position that its fraud counterclaim should not be construed as an "Asset" because it was unknown to Weatherspoon at the time.[10]

Having escaped Duma's counterclaim of fraud, Safranski then argued that Weatherspoon's fraud counterclaim should also be dismissed for lack of standing.[11] The trial court denied that motion for summary judgment, but the court did not enter a written order satisfying RAP 9.12, and no transcript of the hearing is in the appellate record.

Citing *Favors v. Matzka*,[12] Safranski argued to the trial court that Weatherspoon lacked standing because the evidence was insufficient to show that Safranski had a duty to disclose the $160,000 bonus to Weatherspoon.[13]

The case proceeded to trial. The trial court decided that Safranski owed fiduciary duties to Weatherspoon, and the jury was so instructed.[14] At the close of evidence, the Court denied Safranski's CR 50 motion on standing, [15] and the jury found for Weatherspoon on his fraud counterclaim.[16]

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[10] CP 102.
[11] The motion papers related to this motion are found as Appendices E, F and G.
[12] 53 Wn. App. 780, 770 P.2d 686 (1989).
[13] Appendix E, p.4-9.
[14] CP 376.
[15] Supplemental Reporter's Transcript, 03/30/2015 at pp. 60:4-25.
[16] CP 384-5.

In a bifurcated proceeding, the court decided Safranski's direct claim against Weatherspoon, despite Duma having "sold" its derivative claim. The court made an offsetting award against Weatherspoon for Safranski's share of expenses paid by Duma.[17] As part of the final judgment, Duma was voluntarily dissolved.[18]

C. Safranski's Appeal

The Court of Appeals elected to review only the trial court's denial of Safranski's motion for summary judgment, and not the denial of Safranski's CR 50 motion.[19]

Under CR 17(a), a real party in interest is one who has a personal stake in the outcome of the case. In a shareholder case, the Court of Appeals cited *Sabey v. Howard Johnson & Co.* for the general rule:

> Ordinarily, a shareholder cannot sue for wrongs done to a corporation, because the corporation is a separate entity: the shareholder's interest is viewed as too removed to meet the standing requirements.[20]

The *Sabey* court, however, summarized two exceptions found in the common law:

> There are two often overlapping exceptions to the general rule: (1) where there is a special duty, such as a contractual duty, between the wrongdoer and the shareholder; and

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[17] CP 425-27. The inconsistency in Safranski's standing argument – he had a claim against Weatherspoon, but Weatherspoon had no claim against him – should not be lost.
[18] CP 468.
[19] Opinion at p.4.
[20] *Sabey*, 101 Wn. App. at 584.

> (2) where the shareholder suffered an injury separate and distinct from that suffered by other shareholders.[21]

As to the "special duty" exception, the *Sabey* court further explained:

> The special duty need not arise from a contract. The question is whether a duty was owed to the **individual independent of his status as a shareholder**:
>
> > As an exception to the general rule, a stockholder may maintain an action in his own right **against a third party** (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from violation of some special duty owed to the stockholder but only when that special duty **had its origin in circumstances independent of the stockholder's status as a stockholder**.[22]

Neither *Sabey* nor *Hunter* addressed a shareholder-to-shareholder direct claim of fraud like the situation here. In *Sabey*, the plaintiff-shareholder sued a third-party – a consultant who had advised the corporation. To oppose the consultant's summary judgment motion, the plaintiff-shareholder pointed to evidence that the consultant had made statements directly to the shareholder, and his personal counsel, upon which the shareholder had relied to his detriment. Under the tort of negligent misrepresentation, the Court of Appeals found evidence

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[21] *Id.*

[22] *Id.*, 101 Wn. App. at 585; citing *Hunter v. Knight, Vale & Gregory*, 18 Wn. App. 640, 646, 571 P.2d 212 (1977) (emphasis added).

sufficient to create a fact issue supporting a duty the consultant owed directly to the plaintiff – a duty that was unrelated to (or independent of) the plaintiff's status as a stockholder.

In *Hunter v. Knight, Vale & Gregory*,[23] like *Sabey,* the plaintiff sought recovery from a third-party tortfeasor – the corporation's accounting firm. Unlike *Sabey*, there was no duty owed by the accounting firm to the plaintiff shareholder, other than vicariously through the duty the firm owed to the corporation. Therefore, the plaintiff-shareholder in *Hunter* lacked standing.

This case does not involve a shareholder's suit against a third-party tortfeasor. Weatherspoon successfully sued a fellow shareholder who defrauded him. And in *Sabey* and *Hunter* the corporations had their own tort claims against the tortfeasors, whereas here, the shareholder's fraud caused the corporation to lose its claim for fraud. No Court of Appeals decision has ruled on this type of case.

Courts in other jurisdictions, however, have authorized direct shareholder-to-shareholder fraud claims, as the Court of Appeals recognized.[24] Authorities such as *Fletcher Cyclopedia of the Law of*

[23] 18 Wn. App. 640, 646, 571 P.2d 212 (1977).
[24] Opinion at p.6.

Corporations[25] have identified comparable examples where courts have found standing to sue:

> 4. Actions directly relating to the stock held by the shareholder, including ... fraud in inducing a subsequent sale of stock ...
>
> 8. Acts depriving a shareholder or member of rights ... including acts depriving one of the advantage of majority control.[26]

The same common law rule is summarized by *American Jurisprudence*:

> A stockholder may maintain an individual, as distinct from a derivative, action against directors, officers or others for wrongs constituting a direct fraud on him or her, such as being induced to purchase stock in a corporation and pay a higher price than the stock was fairly and reasonably worth, or being induced to sell stock for a sum less than its true value by reason of false or fraudulent representations by others, or losing control of the corporation as a result of fraud.[27]

Confronted by these authorities, Safranski admitted at oral argument that had the APA been a stock sale, Weatherspoon would have had standing to sue Safranski.[28]

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[25] 12B William Meade Fletcher, *Fletcher Cyclopedia of the Law of Corporations* (2009) was cited by the Court of Appeals in *Sabey* and *Hunter*, and in this case. Opinion at p.5, n.3 (stating Washington courts "have expressly adopted" *Fletcher*). The fact-specific nature of shareholder standing is seen by the author's devotion of an entire chapter to "Direct Actions by Shareholders As Distinguished From Shareholder Derivative Actions," *Fletcher*, Chapter XXXII.

[26] *Fletcher* at §5915, p.542.

[27] 19 *Am. Jur. 2d Corporations* §1955 (2004).

[28] Appendix C, p.5.

To avoid this outcome, though, Safranski drew a distinction without a legal difference. Because the sale was structured as an asset sale, Safranski argued, these authorities did not apply: "because the APA was an asset sale, Weatherspoon's ownership of Duma shares was not diluted – he was the controlling shareholder of Duma before the APA, and he remained the controlling shareholder of Duma after the APA."[29]

The Court of Appeals agreed this distinction was dispositive[30]:

> But Weatherspoon fails to show how he lost control of Duma Inc. when he merely sold Duma Inc.'s assets and not his Duma Inc. stock. At all relevant times, Weatherspoon remained the majority shareholder of Duma Inc. Thus, Weatherspoon's argument that he had standing because he suffered a direct injury by loss of control of Duma Inc. fails.
>
> Next, Weatherspoon asserts that he suffered a direct injury because of losing value of Duma stock. But Weatherspoon's monetary damages were sustained indirectly as a result of the injury to the corporation. ... Weatherspoon suffered injury only to the extent that the value of Duma Inc.'s stock was decreased by Safranski's fraud.[31]

There is no principled difference between a shareholder losing control of a closely-held corporation by selling his stock versus losing control of all of the corporation's assets in an asset sale transaction. Nor is

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[29] Appellant's Reply Brief at pp.37.
[30] The APA is not in the appellate record.
[31] Opinion at pp.6–7.

there any meaningful distinction between a shareholder's interest being de-valued in an asset sale rather than a stock transaction.

The APA devalued Weatherspoon's interest in Duma's assets by greatly enhancing the risk that BMS would not pay for them, while also selling the right of the corporation to be compensated for its loss through a fraud claim. Similarly, selling all of Duma's assets meant Weatherspoon lost control of Duma, by losing control over all of its assets, especially its proprietary IP.

D. Conflicting Interpretation of Two Exceptions

(1) Special Duty Exception.

Under this exception, *Sabey* directs that "the question is whether a duty was owed to the individual independent of his status as a shareholder."[32]

But the Court of Appeals inexplicably bypassed this crucial step. Instead of looking at Safranski's duty, the Court of Appeals looked only to the result of Safranski's fraud:

> But as discussed above, Weatherspoon did not sell Duma Inc.; he retained ownership of Duma Inc.; as stock. Instead, Duma Inc. sold its *assets*. Therefore, Safranski's actions did not cause any personal loss to Weatherspoon apart from the loss of value of the stock, which is based solely on Weatherspoon's status as a stockholder.[33]

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[32] *Sabey,* 101 Wn. App. 585.
[33] Opinion at p.8.

By failing to analyze the duty question, the Court of Appeals conflated this exception with the second exception that **does** look to the resulting harm. The fundamental issue is one of duty, not harm, under the first exception.

Safranski's **duty** to avoid this fraud was not dependent on and did not have its origin in Weatherspoon's status as a shareholder. As an individual, Weatherspoon was misled by an individual who intended to mislead him. The fact that Weatherspoon was a shareholder when he was defrauded, or that he acted on the fraud using his rights as a shareholder, does not mean Safranski's duty arose out of Weatherspoon's shareholder status.

Safranski's liability attached as an individual when he made intentional misrepresentations about his employment, just as the consultant in *Sabey* owed an independent duty to the shareholder not to make the negligent misrepresentations about the corporation's unfunded pension liability.

(2) Distinct Harm Exception.

The Court of Appeals addressed the second exception recognized by *Sabey:* "where a shareholder suffers harm that was separate and

distinct from that suffered by other shareholders."[34] The Court of Appeals' analysis clearly demonstrates how it conflated the special duty exception with the distinct harm exception. The Court applied the same rationale to deny both exceptions.

There were only two shareholders when Safranski's fraud caused Duma to lose the earn out payment of $350,000: Weatherspoon, the victim, and Safranski, the fraud-doer. Safranski's "harm" in not receiving his interest in the Earn Out was more than compensated by the fruit of his fraud: the $160,000 bonus payment.

And yet the Court of Appeals dispatched this exception by misinterpreting the exception in *Sabey.* "Weatherspoon argues that he suffered distinct damages because Safranski's actions devalued Weatherspoon's shares but not Safranski's shares."[35]

Weatherspoon actually argues under the second exception that the damages he sustained due to Safranski's fraud – the failure to receive his interest in the $350,000 Earn Out payment – "was separate and distinct from that suffered by other shareholders."[36] The only other shareholder whose harm could be compared to Weatherspoon's harm was Safranski – the fraud-doer. To hold that Weatherspoon and Safranski suffered the

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[34] *Sabey*, 101 Wn. App. at 584.
[35] Opinion at 8.
[36] *Sabey,* 101 Wn. App. at 584.

same harm is to ignore the very essence of the fraud: Safranski successfully traded his 20 percent interest in the $350,000 Earn Out payment for a $160,000 personal bonus. Safranski suffered no harm, because his loss was more than made up by the $160,000 bonus he received by defrauding Weatherspoon. Moreover, the fraud prevented Duma from recovery against Safranski – a loss that Weatherspoon, but not Safranski – suffered.

E. Another Common Law Exception Not Considered

Courts have also recognized shareholder standing in other circumstances. For example, the rule is laid down in *American Jurisprudence* that:

> In addition, an individual action [by a shareholder] will be allowed ***if there is a fiduciary relationship*** between the parties, which requires the wrong-doer to protect the interests of the stockholder, and if that duty has been violated and ***full relief to the stockholder cannot be had through a recovery by the corporation***.[37]

The trial court determined that Safranski owed fiduciary duties to Weatherspoon, and the jury was so instructed.[38]

Under the rule stated above, not only was full relief to Weatherspoon unavailable through the corporation, ***no*** relief was available to him, because Safranski's fraud extinguished the corporation's claim.

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[37] 19 *Am. Jur. 2d Corporations* §1956 (2004) (emphasis added).
[38] CP 376, 377.

Additionally, "courts may allow shareholders who own all of the stock of the company to proceed against each other directly under the principle that there are no persons not before the court who can be affected by the litigation and that there is no danger of a multiplicity of lawsuits – two reasons used to justify the requirement of a derivative action."[39]

Here, the only two shareholders were before the trial court seeking redress for wrongs they each alleged the other had committed. The policy concerns that justify the need for derivative actions were wholly absent. The Court of Appeals wrongly decided only Safranski – not Weatherspoon – had remedies.

F. Why Review Should Be Accepted

This case illustrates a clear and compelling need for the Court to address shareholder standing for the first time. Unlike most states, Washington surprisingly lacks precedent from its highest appellate court. This Court's guidance and direction to lower courts, legal practitioners, and business owners is imperative. The core issue here has broad implications in Washington, because the field of corporate law depends on known and predictable standards.

Safranski's answer that under an asset sale the corporation may technically remain "alive" and able to sue either directly or through a

[39] *Fletcher* at §5911.5, p.529.

derivative action is no answer. An asset sale transaction typically includes, as it did here, a provision transferring the seller's causes of action. The nub of this case is that Safranski inoculated himself from the corporation's claim of fraud.

The issue presented for review is not a choice between a corporate claim and a shareholder claim. It is well recognized that a shareholder may have standing to sue, "although the corporation may likewise have a cause of action for the same wrong."[40]

Here, if Weatherspoon had no standing, no one had standing – and fraud had no consequences.

VI. TRIAL COURT DECISION WAS NOT REVIEWABLE

The Court of Appeals misinterpreted both the trial court decision and this Court's rule that:

> When a trial court denies summary judgment due to factual disputes, as here, and a trial is subsequently held on the issue, the losing party must appeal from the sufficiency of the evidence presented at trial, not from the denial of summary judgment. *See Johnson v. Rothstein, 52 Wn. App. 303, 759 P.2d 471 (1988).*

Adcox v. Children's Orthopedic Hospital and Medical Center.[41]

Citing *Univ. Vill. Ltd. Partners v. King County*,[42] the Court of Appeals nonetheless reviewed the denial of Safranski's motion for

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[40] *Sabey*, 101 Wn. App. at 595.
[41] 123 Wn.2d 15, 35 n.9, 864 P.2d 921 (1993).

summary judgment, deeming the trial court's decision to be "a legal issue."[43]

Initially, a review of this particular trial court decision is even more unavailable because the trial court did not enter a written order required by RAP 9.12. Safranski failed to order a transcript of the hearing, or submit any of the documentary evidence furnished by the parties. There is no record upon which the Court of Appeals could determine the basis of the trial court's decision.

Simply because a party's standing to sue is a legal issue decided by the court does not mean that a summary judgment motion on standing cannot, as here, involve factual issues. In *Sabey*, for example, the defendant consultant's statements were deemed sufficient to create a material issue of fact.

Likewise, the evidence established a material issue of fact concerning whether Safranski's disputed conduct was sufficient to establish a duty owed to Weatherspoon to disclose the bonus arrangement, independent of Weatherspoon's shareholder status.

At trial, Safranski raised the issue again under CR 50. Safranski has appellate recourse to challenge the CR 50 denial, but not the earlier denial of summary judgment.[44]

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[42] 106 Wn. App. 321, 324, 23 P.3d 1090 (2001).
[43] Opinion at p.4, n.2.

VII. CONCLUSION

The Court's review would provide much needed precedent in an area that affects a significant segment of the state's economy. No shareholder should be allowed to vanquish a corporation's claim of fraud, and then use the fruit of his own fraud as a shield to avoid liability. The common law of shareholder standing does not countenance such injustice.

Weatherspoon respectfully requests the Court accept discretionary review.

DATED this 12th day of May, 2017.

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[44] Because the issue was one of a party's standing to sue, Safranski might also have asked the Court of Appeals to accept discretionary review of the summary judgment denial before trial. RAP 2.3.

CERTIFICATE OF SERVICE

The undersigned hereby certifies as follows:

1. My name is Heather A. Dumont. I am a citizen of the United States, over the age of eighteen (18) years, a resident of the State of Washington, and am not a party of this action.

2. On the 12th day of May, 2017, I served a copy of the foregoing **RESPONDENT SULTAN WEATHERSPOON'S PETITION FOR REVIEW** via First Class United States Mail, postage prepaid, to the following persons:

Steven E. Turner
Steven Turner Law PLLC
1409 Franklin St Ste 216
Vancouver, WA 98660-2826
Attorneys for Appellant Alex Safranski

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

DATED: May 12, 2017

At: Vancouver, Washington

/s/ Heather Dumont
HEATHER A. DUMONT

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Filed
Washington State
Court of Appeals
Division Two

January 24, 2017

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

ALEX SAFRANSKI, an individual Appellant/Cross-Respondent, v. DUMA VIDEO, INC., a Washington corporation, and Sultan Weatherspoon, an individual, Respondents/Cross-Appellants.	No. 47716-5-II UNPUBLISHED OPINION

JOHANSON, J. — Alex Safranski appeals the trial court's summary judgment order denying dismissal of Sultan Weatherspoon's fraud claim. Weatherspoon cross appeals a prejudgment interest award to Safranski. We hold that Weatherspoon lacks standing, and therefore we reverse and remand for entry of an order granting summary dismissal of Weatherspoon's fraud claim.[1] We also affirm the prejudgment interest award.

[1] Safranski also appeals the denial of his motion to remit the jury award to Weatherspoon. We do not reach the remittitur issue because of our decision to reverse the summary judgment order due to Weatherspoon's lack of standing.

FACTS

I. BACKGROUND

Weatherspoon founded Duma Video Inc. (Duma Inc.) in 2001 to develop and patent video software. In 2003, Weatherspoon employed Safranski as a software programmer and gave Safranski 20 percent of Duma Inc. stock. Broadcast Microwave Services Inc. (BMS) was a customer of Duma Inc.

In 2012, Safranski asserted a claim against Duma Inc. for Weatherspoon's alleged improper business expense reimbursements. The parties agreed that due to irreconcilable differences, the best course of action was to solicit a sale of Duma Inc.'s assets to BMS. But, unbeknownst to Weatherspoon, Safranski entered into an employment contract with BMS that included the promise of a substantial payment to him contingent on Safranski's delivery of a decoder.

Thereafter, because Weatherspoon did not know about Safranski's deal with BMS, Duma Inc. entered into an asset purchase agreement (APA) wherein Duma Inc. sold its assets to BMS. Under the APA, BMS agreed to pay Duma Inc. for its assets and to pay an additional "earn-out" contingent on Duma Inc.'s delivery of a decoder. But Safranski delivered his decoder first. BMS paid Duma Inc. for its assets, but rejected Duma Inc.'s decoder and refused to pay Duma Inc. the earn-out payment because BMS needed only one decoder.

Safranski filed suit against Weatherspoon for breaching his duties to Duma Inc. by taking improper reimbursements for nonbusiness expenses. Weatherspoon and Duma Inc. asserted fraud counterclaims against Safranski. Weatherspoon alleged that he suffered financial loss because Safranski fraudulently induced Weatherspoon to sell the assets of Duma Inc., which Weatherspoon

would not have done if Safranski had revealed the truth about his employment agreement with BMS. Weatherspoon claimed monetary damages.

II. Summary Judgment on Standing

Safranski moved for summary judgment against Duma Inc.'s and Weatherspoon's fraud counterclaims based on lack of standing. Weatherspoon argued that he had an individual, direct claim of fraud against Safranski rather than a shareholder's claim requiring proof of a special duty. The trial court dismissed Duma Inc.'s claims because Duma assigned all lawsuits to BMS as part of the purchase agreement and therefore Duma Inc. lacked standing to sue. But the trial court denied the summary judgment motion with respect to Weatherspoon's standing to bring a fraud claim against Safranski.

III. Trial

The case proceeded to trial. A jury found Safranski liable to Weatherspoon for fraud and awarded damages.

Regarding Safranski's claim that Weatherspoon falsely received expense reimbursement from Duma Inc., the parties stipulated to $279,290 in undocumented expenses. Following a bench trial, the trial court awarded Safranski $105,744. The trial court found all of Safranski's claims were liquidated and awarded $37,429 in prejudgment interest.

Safranski appeals the trial court's denial of his summary judgment motion to dismiss. Weatherspoon cross appeals the prejudgment interest award.

ANALYSIS

I. WEATHERSPOON'S STANDING

Safranski argues that the trial court erred by denying his motion for summary judgment because Weatherspoon lacked standing to bring a claim against Safranski under the general rule that shareholders cannot sue for harm to a corporation or its exceptions. Weatherspoon argues that he had individual standing to directly assert a fraud claim against Safranski and had standing under the exceptions to the general rule.[2] We agree with Safranski.

A. STANDARD OF REVIEW

We review a summary judgment denial de novo and engage in the same inquiry as the trial court. *SentinelC3, Inc. v. Hunt*, 181 Wn.2d 127, 140, 331 P.3d 40 (2014). Summary judgment shall be granted if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. CR 56(c). "On a motion for summary judgment, all facts submitted and reasonable inferences therefrom must be viewed in the light most favorable to the nonmoving party." *SentinelC3*, 181 Wn.2d at 140. "Whether a party has standing to sue is

[2] Weatherspoon also argues that Safranski cannot appeal the denial of his summary judgment motion because a trial was already held on the factual issues. We disagree. Generally, the denial of summary judgment may be reviewed after the entry of a final judgment if summary judgment was denied based on a substantive legal issue. *Univ. Vill. Ltd. Partners v. King County*, 106 Wn. App. 321, 324, 23 P.3d 1090 (2001). Whether a party has standing to sue is a legal issue. *Trinity Universal Ins. Co. of Kansas v. Ohio Cas. Ins. Co.*, 176 Wn. App. 185, 199, 312 P.3d 976 (2013). Because Weatherspoon's motion for summary judgment turned on the legal issue of standing, we may review it. Weatherspoon also argues that we cannot properly review the denial of the CR 50 motion renewing Safranski's summary judgment motion because Safranski failed to designate the trial record. But we do not reach the CR 50 motion.

a question of law reviewed de novo." *Trinity Universal Ins. Co. of Kansas v. Ohio Cas. Ins. Co.*, 176 Wn. App. 185, 199, 312 P.3d 976 (2013).

B. LEGAL PRINCIPLES

"Every action shall be prosecuted in the name of the real party in interest." CR 17(a). "The standing doctrine requires that a plaintiff must have a personal stake in the outcome of the case in order to bring suit." *Sabey v. Howard Johnson & Co.*, 101 Wn. App. 575, 584, 5 P.3d 730 (2000).

"Ordinarily, a shareholder cannot sue for wrongs done to a corporation, because the corporation is a separate entity: the shareholder's interest is viewed as too removed to meet the standing requirements." *Sabey*, 101 Wn. App. at 584. "Even a shareholder who owns all or most of the stock, but who suffers damages only indirectly as a shareholder, cannot sue as an individual." *Sabey*, 101 Wn. App. at 584.

But a shareholder may "sue to redress direct injuries to him or herself regardless of whether the same violation injured the corporation." 12B *William Meade Fletcher, Fletcher Cyclopedia of the Law of Corporations*, § 5911, at 526 (2009).[3] Thus, whether a shareholder has a direct claim turns on who suffered the alleged harm and who would receive the benefit of any recovery or other remedy. *Id.*, at 517. If damages to a shareholder result indirectly as the result of injury to a corporation and not directly, the shareholder cannot sue as an individual. *Id.*, at 522. An individual cause of action can be asserted when the wrong is to both the shareholder and to the corporation. *Id.*, at 517.

[3] Washington courts have expressly adopted analysis from *Fletcher Cyclopedia of the Law of Corporations*. *See Sabey*, 101 Wn. App. at 584-85. And both parties rely on *Fletcher* to explain the types of suits that may be brought by shareholders.

Fraudulent acts depriving a shareholder of his or her rights from the advantage of majority control of a corporation is among the type of cases that enable a shareholder to sue under a direct claim. 12B *Fletcher* § 5915, at 544-45. "A stockholder may maintain an individual, distinguished from a derivative, action against directors, officers, or others for wrongs constituting a direct fraud on him or her, such as losing control of the corporation as a result of fraud." 19 AM. JUR. 2D *Corporations* § 1943 (2016).

C. WEATHERSPOON LACKS STANDING UNDER THE GENERAL RULE

To determine if Weatherspoon had standing to sue, we analyze whether Weatherspoon had a direct claim. Whether Weatherspoon had a direct claim depends on the injury sustained. Weatherspoon argues that he sustained an individual injury based on either loss of control of Duma Inc. or a diminution of the value of Duma Inc.'s stock as a result of Safranski's fraudulent acts.[4]

Weatherspoon maintains that as a result of Safranski's misrepresentations, he relinquished control of Duma Inc. as the majority shareholder by selling it to BMS. But Weatherspoon fails to show how he lost control of Duma Inc. when he merely sold Duma Inc.'s assets and not his Duma Inc. stock. At all relevant times, Weatherspoon remained the majority shareholder of Duma Inc. Thus, Weatherspoon's argument that he had standing because he suffered a direct injury by loss of control of Duma Inc. fails.

Next, Weatherspoon asserts that he suffered a direct injury because of the loss of value of Duma stock. But Weatherspoon's monetary damages were sustained indirectly as a result of the

[4] Weatherspoon argues that in addition to having standing as a result of his fraud claim, he had standing to sue Safranski on the basis of a breached fiduciary duty that Safranski owed him. Weatherspoon concedes that below he stated that his standing did not derive from a fiduciary duty. Therefore, we do not address this claim.

injury to the corporation. Weatherspoon claims that as a result of Safranski's fraud, Duma Inc. lost the full value of its assets and the loss of the "earn-out" payment. But the monetary loss was to Duma Inc. and not to Weatherspoon directly. It was Duma Inc. who sold its assets to BMS, not Weatherspoon.

Weatherspoon suffered injury only to the extent that the value of Duma Inc.'s stock was decreased by Safranski's fraud. Thus, Weatherspoon's claim for monetary damages is only indirect. Weatherspoon's argument that he had standing as a result of a direct monetary loss fails.

D. Exceptions to the General Rule

Next, we determine whether Weatherspoon could have asserted a claim based on exceptions to the general rule that shareholders cannot sue for harm done to a corporation: the special duty exception and the separate and distinct injury exception. Safranski argues that Weatherspoon's claims did not fit either exceptions to the rule.[5] Weatherspoon argues that his claim qualifies under both exceptions. We agree with Safranski.

1. The "Special Duty" Exception

One exception to the general rule that a shareholder cannot sue for wrongs done to a corporation is where there is a special duty between the wrongdoer and the shareholder. *Sabey*, 101 Wn. App. at 584. Whether there was a special duty depends on whether a duty was owed to the individual independent of his status as a shareholder. *Sabey*, 101 Wn. App. at 585.

[5] Safranski argues that Weatherspoon did not bring a derivative claim nor does his claim fall within the exception for derivative claims. Weatherspoon concedes that he cannot meet the derivative suit requirements. We accept Weatherspoon's concession. Duma Inc.'s fraud claim was dismissed because its claim was sold to BMS, thus Weatherspoon could not have maintained an action based on Duma Inc.'s right to sue.

Here, Weatherspoon argues that he had standing to bring a direct claim of fraud against Safranski because Safranski fraudulently induced Weatherspoon to sell his corporation at a disadvantage. But as discussed above, Weatherspoon did not sell Duma Inc.; he retained ownership of Duma Inc.'s stock. Instead, Duma Inc. sold its *assets*. Therefore, Safranski's actions did not cause any personal loss to Weatherspoon apart from the loss of value of the stock, which is based solely on Weatherspoon's status as a shareholder.

Weatherspoon's argument fails because it is based on the unsupported claim that he was fraudulently induced to sell his corporation. Thus, Weatherspoon fails to establish that a special duty was owed to him independent of his shareholder status.

2. SEPARATE AND DISTINCT INJURY EXCEPTION

A shareholder may sue for wrongs done to a corporation when the shareholder brings a claim that he suffered an injury separate and distinct from that suffered by other shareholders. *Sabey*, 101 Wn. App. at 584-85.

Weatherspoon argues that he suffered distinct damages because Safranski's actions devalued Weatherspoon's shares but not Safranski's shares. He claims that Safranski's shares were not devalued because Safranski obtained a $160,000 bonus from his employment contract with BMS. But Weatherspoon fails to explain how Safranski's profit from his employment contract from BMS uniquely altered the value of Safranski's shares in Duma Inc. When BMS bought Duma Inc. and did not pay the earn-out as expected as a result of Safranski's fraud, presumably both Weatherspoon and Safranski were valued less for their shares in Duma Inc. than they would have been otherwise. Thus, Weatherspoon's injury was not separate and distinct from other shareholders.

Next, Weatherspoon claims that he would not have sold Duma Inc. under the terms of the APA if it had not been for Safranski's fraud. But as previously discussed, it was Duma Inc. that sold its assets and it was Duma Inc. that suffered the financial loss as a result of Safranski's fraud. Weatherspoon, as a Duma Inc. shareholder, suffered a loss only indirectly due to the devaluation of Duma Inc. stock. And to the extent Weatherspoon asserts that he lost control of Duma Inc., that assertion is unsupported by any evidence. Weatherspoon remained in control of Duma Inc. after the sale. Thus, we hold that Weatherspoon did not suffer a distinct and separate injury from other Duma Inc. shareholders either because he lost control of Duma Inc.'s assets or because of the devaluation of Duma Inc.'s stock.

We hold that Weatherspoon lacked standing to sue Safranski for fraud and that the trial court improperly denied Safranski's summary judgment dismissal motion.

II. Cross Appeal

A. Prejudgment Interest

Weatherspoon argues that the trial court abused its discretion by awarding Safranski prejudgment interest because in order to conclude that a liquidated or ascertainable amount of money was owed to Safranski, the trial court was required to make a finding that Weatherspoon improperly retained money. Weatherspoon claims that the trial court made no such finding. Safranski argues that a finding that Weatherspoon improperly misappropriated the funds was not required and the trial court properly found that Safranski's claim was liquidated in order to award prejudgment interest. We agree with Safranski.

B. STANDARD OF REVIEW AND RULES OF LAW

We review a trial court's order on prejudgment interest for abuse of discretion. *Scoccolo Constr., Inc. v. City of Renton*, 158 Wn.2d 506, 519, 145 P.3d 371 (2006). A trial court abuses its discretion when its order is manifestly unreasonable or based on untenable grounds or reasons. *Olver v. Fowler*, 161 Wn.2d 655, 663, 168 P.3d 348 (2007). "'Prejudgment interest is favored in the law based on the premise that he who retains money he should pay to another should be charged interest on it.'" *Spradlin Rock Prods., Inc. v. Pub. Util. Dist. No. 1 of Grays Harbor County*, 164 Wn. App. 641, 665, 266 P.3d 229 (2011) (quoting *Universal/Land Constr. Co. v. City of Spokane*, 49 Wn. App. 634, 641, 745 P.2d 53 (1987)). "The plaintiff should be compensated for the 'use value' of the money representing his damages for the period of time from his loss to the date of judgment." *Hansen v. Rothaus*, 107 Wn.2d 468, 473, 730 P.2d 662 (1986).

C. NO FINDING THAT THE WITHHOLDING WAS IMPROPER IS REQUIRED

Weatherspoon's argument rests on the notion that the trial court was required to find that the reimbursements were improper rather than just undocumented. Weatherspoon concedes that the parties stipulated at trial that Weatherspoon asked for reimbursement from Duma Inc. for $279,290 in *undocumented* expense reimbursements. Weatherspoon argues that the parties did not stipulate nor did the trial court find that the expense reimbursements were for *improper* personal expenses. We reject Weatherspoon's contention.

Weatherspoon cites to no authority that a finding of improper withholding is required to show the money was owed to Safranski in support of an award of prejudgment interest. The trial court's lack of finding that the total stipulated amount was used for improper expenses is irrelevant:

prejudgment interest is not a penalty imposed for wrongdoing nor is its purpose to deter wrongdoing. *Hansen*, 107 Wn.2d at 475.

D. SAFRANSKI'S CLAIM WAS LIQUIDATED

Weatherspoon argues that Safranski's claim was not liquidated such that the trial court lacked a basis to justify the award of prejudgment interest. We disagree.

A trial court may award prejudgment interest if the amount claimed is liquidated. *Safeco Ins. Co. v. Woodley*, 150 Wn.2d 765, 773, 82 P.3d 660 (2004). A claim is liquidated where the evidence furnishes data that if believed, makes it possible to compute the amount with exactness, without reliance on opinion or discretion. *Dautel v. Heritage Home Ctr., Inc.*, 89 Wn. App. 148, 153, 948 P.2d 397 (1997). "It is the character of the original claim, rather than the court's ultimate method for awarding damages, that determines whether prejudgment interest is allowable." *Spradlin*, 164 Wn. App. at 665 (citing *Prier v. Refrigeration Eng'g Co.*, 74 Wn.2d 25, 33, 442 P.2d 621 (1968)). "That a claim is disputed does not make it unliquidated." *Spradlin*, 164 Wn. App. at 665.

Here, Safranski claimed that Weatherspoon was improperly reimbursed for at least $350,000 in reimbursements for alleged business expenses and falsely represented that the expenses were reasonable and necessary business expenses for Duma Inc. Weatherspoon concedes that the parties stipulated at trial that Weatherspoon asked for reimbursement from Duma Inc. for $279,290 in *undocumented* expense reimbursements. Thus, Safranksi's claim alleged an ascertainable amount owed that Safranski would establish at trial.

This claim was liquidated because if Safranski's evidence about Weatherspoon's fraudulent business expense reimbursements was believed, it would be possible to compute the

amount with exactness, without reliance on the trial court's opinion or discretion. *Dautel*, 89 Wn. App. at 153. Because the amount claimed by Safranski was liquidated, the trial court could award prejudgment interest. *Safeco Ins. Co.*, 150 Wn.2d at 773. Thus, we hold that the trial court did not abuse its discretion by awarding prejudgment interest and the award is affirmed.

We reverse the trial court's denial of Safranski's summary dismissal motion and affirm the trial court's prejudgment interest award to Safranski.

A majority of the panel having determined that this opinion will not be printed in the Washington Appellate Reports, but will be filed for public record in accordance with RCW 2.06.040, it is so ordered.

Johanson, J.
JOHANSON, J.

We concur:

Maxa, A.C.J.
MAXA, A.C.J.

Melnick, J.
MELNICK, J.

Filed
Washington State
Court of Appeals
Division Two

April 12, 2017

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

ALEX SAFRANSKI, an individual Appellant/Cross-Respondent, v. DUMA VIDEO, INC., a Washington corporation, and Sultan Weatherspoon, an individual, Respondents/Cross-Appellants.	No. 47716-5-II ORDER DENYING MOTION TO PUBLISH AND MOTION TO RECONSIDER

Respondent/Cross-Appellant Sultan Weatherspoon moves to publish and reconsider the Court's January 24, 2017 opinion. Upon consideration, the Court denies the motions. Accordingly, it is

SO ORDERED.

PANEL: Jj. Johanson, Maxa, Melnick

FOR THE COURT:

Johanson, J.

JOHANSON, J.

COURT OF APPEALS, DIVISION II

OF THE STATE OF WASHINGTON

ALEX SAFRANSKI, Appellant/ Cross-Respondent, v. SULTAN WEATHERSPOON, Respondent/ Cross-Appellant.	)	No. 47716-5-II

VERBATIM REPORT FROM AUDIO FILE

OF ORAL ARGUMENT

BEFORE THE WASHINGTON COURT OF APPEALS

* * *

October 31, 2016

Amy E. Joyeux, CCR

Court Reporter

APPEARANCES:

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Also Present: None

VANCOUVER, WASHINGTON; MONDAY, OCTOBER 31, 2016

* * *

PROCEEDINGS

[Requested audio begins.]

THE COURT: I'm going to give you one more minute on the cross-appeal on that.

MR. SEIDL: Okay.

THE COURT: Go ahead.

Clerk, add two minutes into the [indiscernible].

MR. TURNER: Thank you, Your Honor. So of course what Mr. Weatherspoon would like to do is avoid the test in Sabey because he doesn't qualify, Your Honor, with those tests. So he makes this broad argument that he can bring this action directly because it's a shareholder-to-shareholder action.

But, of course, almost all -- many, many derivative lawsuits are shareholder-to-shareholder actions. Sound Infiniti [phonetic] was a shareholder-to-shareholder action that would include -- that involves all the members. Corless [phonetic] was a shareholder-against-shareholder action that involved all the members.

And in a typical case, let's just assume that there's a majority shareholder who just decides to

steal $500,000 from the company, and the minority shareholder says, Hey, you just stole $500,000 from the company.

But, guess what? That minority shareholder has to bring a derivative action because the claim is not his. It belongs to the company. The company is the real party in interest.

THE COURT: [Indiscernible].

MR. TURNER: Right. Which of course wouldn't happen in that case. And that's why we have the derivative action is because if the company makes demand, the company says no, then the minority shareholder can bring it.

The rule that Mr. Seidl is asking you to adopt would basically throw out the entire jurisprudence of derivative actions. He's basically saying in any shareholder-to-shareholder action the shareholder has a direct right of action. And you don't have to go through the company, which is completely the opposite of everything that Mr. Fletcher wrote and everything that the courts have decided about this. Because it could very well be that there are other shareholders.

And then as the court has said, if you allow direct actions, there will be as many lawsuits

as there are shareholders. And it's interesting in this case --

THE COURT: Let me give you a hypothetical.

MR. TURNER: Yes, please.

THE COURT: Let's say this was a [indiscernible].

MR. TURNER: Okay.

THE COURT: Let's say that Mr. Weatherspoon actually sold his stock to BMS; right? Now that he has lost majority control, now he has lost his stock, would there be an action there?

MR. TURNER: Yes. And you know why? Because he would have an injury that's separate and distinct from three other shareholders' injury. If this transaction has simply been Mr. Weatherspoon selling his 80 percent interest to BMS, he's the only one who would have been damaged. He would have had an injury separate and distinct from the other shareholders. Then he would fit within that exception to Sabey.

THE COURT: Now, the question is why should the rule be different [indiscernible] instead of the stock? You're basically cutting all the assets [indiscernible].

MR. TURNER: Because if you want to have

the benefit of the corporate form, and you want to have the limited liability of the corporate form, and you have the transaction fee, the company is selling its assets. You have to live by that sword and die by that sword -- just by -- live by that sword.

And as the courts will say, you can't keep on pretending that the company is a separate existence until it doesn't suit you and then you run to the courthouses as the Zimmerman [phonetic] case, and all of a sudden now that it doesn't help you, it doesn't have a separate existence. You have to have it one way or the other.

I mean, he didn't have to form a company at all. He could have just operated as a sole proprietorship if he wanted [indiscernible]. It could have been a general partnership [indiscernible] the fact of the general partnership. He decided for the LLC because obviously there's significant benefits of that.

But now, I mean, it's just interesting because Mr. Seidl says, Look at who is suing who. Well, if you look at the original counterclaims, it was Duma bringing actions against Mr. Safranski for this very claim. But the problem is

Mr. Weatherspoon outsmarted himself because Mr. Safranski also brought derivative claims on behalf of Duma against Mr. Weatherspoon for the money that he stole from the company.

And what happened? Mr. Weatherspoon says at the trial court, Those claims were sold to BMS; Duma doesn't own them anymore. Therefore, Mr. Safranski's derivative claims have to be dismissed.

And then Mr. Safranski says, Oh, okay, well, that's interesting; well, then I guess Duma also sold its claims to BMS that you're trying to bring against me, and so therefore I want summary judgment against your [indiscernible] of claims. And Mr. Weatherspoon amazingly argued to the trial court, Well, no, that doesn't apply to my claims.

And Judge Gregerson said that the momentum of your logic still hangs in the air because it was only two weeks ago that you were telling me these claims were sold, and now you're telling me that they weren't.

And so again, it's live by the sword die by the sword. Mr. Weatherspoon decided to sell these claims to Duma. That is not anything that Mr. Safranski did. He didn't have to sell them. He

could have tried to buy back the assignments of the claim from BMS. He didn't do that.

And yes, BMS could have the claim depending upon the nature of it. Let's just assume that Mr. Safranski, before the deal went through, stole $300,000 from Duma's bank account. Would BMS bring a claim? Absolutely. Would it be a derivative claim on behalf of Duma? Absolutely. So the claims did continue.

You know, the argument is being made that what Mr. Safranski is looking for is a blanket immunity for his fraud, but that's not the case here at all. What we're saying here is that in every case the plaintiff has to be the real party of interest or they have no standing. And so in this case Mr. Weatherspoon did not have any direct right against Mr. Safranski.

The question also is did Duma continue in business? Yes, Duma did continue in business, excuse me. And not only, excuse me, did Duma continue in business after the [indiscernible] sale, Duma continued in business indefinitely. It could have gone into another line of business. It could have [indiscernible] other assets against the $900,000 that it took in the sale.

This was not Mr. Weatherspoon losing majority of control of Duma. And this was not Mr. Weatherspoon selling his interest into it. This was an asset purchase [indiscernible]. And as I mentioned in Corless and in Lawson -- especially Lawson, I think it was, the Court said, You don't have a need to go into a claim because if anyone was defrauded here, it was the company that entered into the transactions.

Again, you can't try to have the separate existence of the LLC when it suits you, and then when it doesn't suit you say, I lost my shares; I lost my money; Duma doesn't exist.

I mean, throughout the statement of the case, it's, Weatherspoon did this and Weatherspoon -- it's Duma who did it. You have to respect the separate existence of that company. Prejudgment interest has been fully briefed. Mr. Seidl is going to tell you that because --

THE COURT: You're out of time, so --

MR. TURNER: Oh, I'm sorry.

THE COURT: [Indiscernible]. Thank you, Mr. Turner.

MR. TURNER: Thank you.

THE COURT: Mr. Seidl, you have one minute

to come to a prejudgment interest.

MR. SEIDL: Your Honor, I did mention this quick handout --

[Requested audio ends.]

C E R T I F I C A T E

I, Amy E. Joyeux, a Certified Court Reporter for Washington, pursuant to RCW 5.28.010 authorized to administer oaths and affirmations in and for the State of Washington, do hereby certify that after having listened to an official audio recording of the proceedings having occurred at the time and place set forth in the caption hereof, that thereafter my notes were reduced to typewriting under my direction pursuant to Washington Administrative Code 308-14-135, the transcript preparation format guidelines; and that the foregoing transcript, pages 1 to 11, both inclusive, constitutes a full, true and accurate record of all such testimony adduced and oral proceedings had on the official audio recording, to the best of my ability, and of the whole thereof.

Witness my hand and CCR stamp at Vancouver, Washington, this 4th day of May 2017.

AMY E. JOYEUX
Certified Court Reporter
Certificate No. 3410

Understanding Stock Versus Asset sale Agreements

T h omas D. Flanigan

McBrayer, McGinnis, Leslie and Kirkland, PLLC

Friday, October 10, 2014

When purchasing or selling an existing business, both the buyer and the seller must determine whether it is advantageous to structure the transaction as a sale and purchase of the assets of a business ("asset sale") or of the ownership interest of the business (a "stock sale"). Understanding the basic differe nces between the two is the first step to structuring a deal that is most beneficial to you, whether you are the buyer or the seller.

The benefits of asset sales

In an asset sale, only the assets of the business are sold while the ownership of the selling company does not change after the close of the transaction. Assets can encompass a wide variety of items such real estate, equipment, inventory, accounts receivable and client lists. Generally, an asset sale is beneficial to a purchaser because favorable assets may be bought while the liabilities that are unfavorable (for example, a risky contract, faulty equipment or an existing lawsuit) can be excluded. In addition, depending on how the purchase price is allocated, the purchaser generally receives a "stepped up" tax basis on the assets which can result in depreciation and amortization tax deductions in the future. A Seller may prefer an asset sale if it intends to sell one division of the company and retain another division as a going concern after the asset sale closes.

Understanding Stock Versus Asset sale Agreements

In that instance, the selling company may use the proceeds from the asset sale to pay off debt or for working capital for the continued operation of the company.

The disadvantages ofasset sales

Asset sales can be more time consuming than a stock sale. Each asset or class of assets generally must be transferred separately - this can be especially cumbersome if an asset is a "shared asset" within a subsidiary or division. Asset sales often require consents and assignments from third parties. For example, a landlord may have to provide consent to substitute the purchaser on the lease agreement.

The benefits of stock sales

In a stock sale, the purchaser buys some or all of the ownership interest of the company directly from individual shareholders and becomes the new owner. The legal status of the company remains the same after the transaction, but the selling stockholders generally "cash out" and are no longer associated with the company. After closing, the selling shareholders are free and clear from the obligations and liabilities (both past and present) associated with it, subject to any indemnification or other obligations contained within the stock sale agreement. A stock sale is usually a quicker transaction than an asset sale because the ownership interest in the company is the only thing being transferred and fewer (if any) third party consents/assignments are necessary. Lastly, from a tax perspective, a selling shareholder may receive a more favorable result with a stock sale.

The disadvantages of stock sales

When a purchaser buys the ownership interest of a company, they effectively buy the company "as- is." All of the obligations and liabilities of the company remain with the company. This can be a dangerous trap for purchasers who fail to perform adequate due diligence or who fail to structure the transaction documents in a way that obligates the seller to fully disclose the company's liabilities. The parties to a stock sale must also take care that they are in compliance with state and federal securities laws.

These are just some of the considerations for purchasers and sellers to contemplate before they begin negotiations. Factors in addition to those mentioned here will affect whether a transaction should be structured as an asset or stock sale, and in fact, there are many elements of the transaction documents for either type of sale that will greatly affect the relative benefits of the transaction to both parties. Future posts will discuss several of the elements of asset and stock sale agreements. To fully understand how the structure of a sale transaction and the documents involved can work to your best advantage, consult with legal counsel.

IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF CLARK

ALEX SAFRANSKI, an Individual, Plaintiff, v. DUMA VIDEO, INC., a Washington Corporation, and Sultan Weatherspoon, an Individual, Defendants.	Case No. 12-2-02882-0 **PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** **(ORAL ARGUMENT REQUESTED)** **Hearing Noted: April 18, 2014 9:00 AM** **(Judge Gregerson)**

I. RELIEF REQUESTED

Plaintiff Alex Safranski ("Safranski" or "Plaintiff") moves for summary judgment on Defendants' counterclaims for fraud and breach of fiduciary duty.

This motion is made on the ground that no genuine issue of material fact exists on Defendants' Duma Video, Inc. ("Duma") and Sultan Weatherspoon ("Weatherspoon") counterclaims for fraud and breach of fiduciary duty, and Plaintiff is entitled to judgment against Defendants as a matter of law.

II. STATEMENT OF FACTS

Plaintiff is a former employee, former director and a current shareholder of Duma. Weatherspoon is the majority shareholder, director and President of Duma. Plaintiff has brought claims against Weatherspoon for improper expense reimbursement payments and against both defendants for failure to pay wages. Defendants have counterclaimed against

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70037.0001 185 MSJ 2 .doc\tec/3/17/14-4f

Plaintiff for fraud and breach of fiduciary duty arising from Plaintiff's employment agreement with Broadcast Microwave Services, Inc. ("BMS").

In the spring of 2012, Weatherspoon offered to sell Duma to BMS, which was a customer of Duma's and the parties negotiated over the next several months. BMS would not agree to buy Duma unless Plaintiff agreed to go to work at BMS and support Duma products. On June 21, 2012, BMS made plaintiff an offer of employment, which included a signing bonus of $80,000 and a project bonus for completion of an FPGA H.264 decoder of $160,000. (See *Exhibit 17 to the Declaration of Steven Naito filed November 22, 2013 in Support of Plaintiff's (initial) Motion for Summary Judgment).* On June 28, 2012, plaintiff and BMS entered into an employment agreement with the $240,000 in bonuses described above. *(See Exhibit 22 to the Declaration of Steven Naito filed November 22, 2013 in Support of Plaintiff's (initial) Motion for Summary Judgment*).

On June 27, 2012, Duma and BMS executed a letter of intent in which BMS would purchase all of Duma's assets with an upfront cash payment of $900,000 and earn-out payments of $350,000. On August 17, 2012, Duma and BMS entered into an Asset Purchase Agreement (the "APA"), to sell Duma's assets upon terms consistent with the letter of intent and closed on the sale of Duma's assets. (See *Exhibit 22 to the Declaration of Steven Naito filed November 22, 2013 in Support of Plaintiff's (initial) Motion for Summary Judgment*)

A. Defendants' Counterclaims.

Duma has brought counterclaims against plaintiff for fraud and breach of fiduciary duty in connection with the sale of Duma's assets to BMS and plaintiff's employment agreement with BMS. Weatherspoon has brought a counterclaim against Plaintiff for fraud in connection with the sale of Duma's assets to BMS and plaintiff's employment agreement with BMS.

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III. STATEMENT OF THE ISSUE

The following issues are presented for resolution by the court:

1. Whether there are genuine material issues of fact in dispute on Defendants' fraud and breach of fiduciary duty counterclaims against Plaintiff.

2. Whether Plaintiff can establish that he is entitled to judgment as a matter of law on Defendants' counterclaims.

IV. EVIDENCE RELIED UPON

This motion is based on:

1. Documents attached to the Declaration of Steven Naito filed November 22, 2013 in Support of Plaintiffs (initial) Motion for Summary Judgment.

2. The excerpts from the transcript of Sultan Weatherspoon's November 12, 2013 deposition attached as Exhibit 24 to the Supplemental Declaration of Steven Naito filed December 16, 2013 in Support of Plaintiff's (initial) Motion for Summary Judgment.

3. The Declarations of Plaintiff Alex Safranski dated November 22, 2013, December 9, 2013, and December 16, 2013, which have been filed with the court.

V. LEGAL AUTHORITY

This motion is made pursuant to CR 56 (b). For the reasons set forth below, plaintiff is entitled to judgment of dismissal of all of Defendants' counterclaims because there is no genuine issue as to any material fact and Plaintiff is entitled to judgment as a matter of law. CR 56 (c).

A. Duma has sold BMS all its rights in and to the counterclaims against Plaintiff.

Section 2.01 of the Asset Purchase Agreement provides in part:

> Purchase and Sale of Assets. Subject to the terms and conditions set forth herein, at the Closing, Seller shall sell, assign, transfer, convey and deliver to Buyer, and Buyer shall purchase from Seller, free and clear of any

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> Encumbrances other than Permitted Encumbrances, all of Seller's right, title and interest in, to and under all of the assets, properties and rights of every kind and nature, whether real, personal or mixed, tangible or intangible (including goodwill), wherever located and whether now existing or hereafter acquired (other than the Excluded Assets), which relate to, or are used or held for use in connection with, the Business (collectively, the "Purchased Assets"), including, without limitation, the following:
>
> ***
>
> (g) all rights to any Actions of any nature available to or being pursued by Seller to the extent related to the Business, the Purchased Assets or the Assumed Liabilities, whether arising by way of counterclaim or otherwise;

Article I of the Asset Purchase Agreement defines "Action" to:

> Mean any claim, action, cause of action, demand, lawsuit, arbitration, inquiry, audit, notice of violation, proceeding, litigation, citation, summons, subpoena or investigation of any nature, civil, criminal, administrative, regulatory or otherwise, whether at law or in equity.

The recitals to the Asset Purchase Agreement define "Business" as follows:

> WHEREAS, Seller is engaged in the business of video, audio and data compression, including encoding and decoding (the "***Business***");

Duma's claims against Plaintiff for fraud and breach of fiduciary duty all relate to the Business and therefore have been sold to BMS. Duma has no standing to bring its counterclaims against Plaintiff.

B. Weatherspoon has no standing to bring his counterclaim for fraud against Plaintiff.

Weatherspoon claims that Plaintiff defrauded Weatherspoon by failing to disclose the terms of Plaintiff's employment agreement with BMS prior to the time Weatherspoon signed the APA and had Weatherspoon known about Plaintiff's FPGA H.264 decoder bonus Weatherspoon never would have signed the APA. Weatherspoon's claim fails as a matter of law because he has no standing to bring a claim for fraud arising out of the APA transaction.

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Duma not Weatherspoon was the party to the APA. Duma owned the assets sold to BMS, not Weatherspoon. Weatherspoon signed the APA not as an individual but as president of Duma. Weatherspoon, in his individual capacity, has no direct connects to the transaction; he is only a shareholder of the seller – Duma. In *Sabey v. Howard Johnson* 101 Wn App 575, 5 P3d 730 (2000) the court stated the rule that a shareholder does not have standing to sue for wrongs to a corporation except in limited circumstances:

> The standing doctrine requires that a plaintiff must have a personal stake in the outcome of the case in order to bring suit. Ordinarily, a shareholder cannot sue for wrongs done to a corporation, because the corporation is a separate entity: the shareholder's interest is viewed as too removed to meet the standing requirements. Even a shareholder who owns all or most of the stock, but who suffers damages only indirectly as a shareholder, cannot sue as an individual. Howard Johnson argues that Sabey was merely a shareholder in F&N Holding and therefore lacks standing.
>
> There are two often overlapping exceptions to the general rule: (1) where there is a special duty, such as a contractual duty, between the wrongdoer and the shareholder; and (2) where the shareholder suffered an injury separate and distinct from that suffered by other shareholders.
>
> Sabey asserts both exceptions here. As to the existence of a special duty, Howard Johnson points out that it was not in contractual privity with Sabey. While this is true, it is not dispositive. The special duty need not arise from a contract. The question is whether a duty was owed to the individual independent of his status as a shareholder:
>
> > "As an exception to the general rule, a stockholder may maintain an action in his own right against a third party (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from the violation of some special duty owed to the stockholder but only when that special duty had its origin in circumstances independent of the stockholder's status as a stockholder."
>
> *Id* at 585 (quoting *Hunter v. Knight, Vale & Gregory* , 18 Wn. App. 640, 646, 571 P.2d 212 (1977).

Thus in order for Weatherspoon to have standing to bring his counterclaim he must prove (1) that Plaintiff owed Weatherspoon a "special duty" that arose from some relationship other than Weatherspoon's status as a Duma shareholder and (2) that he suffered damages

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separate and distinct from other shareholders. Weatherspoon's counterclaims against Plaintiff fail to satisfy either exception to the rule that shareholders have no standing to sue from wrongs done to the corporation.

Weatherspoon's alleged damages are based upon his pro-rata ownership of Duma's shares and are identical to damages suffered by other shareholders (including Plaintiff) of Duma. (*See paragraphs 78 and 79 of Defendants' Answer to Third Amended Complaint.*) Second, Weatherspoon has failed to identify any "special duty" owed him by Plaintiff, let alone any duty that arises independent of Weatherspoon's status as a shareholder of Duma.

Plaintiff as an employee and director of Duma owed a fiduciary duty to Duma, not Weatherspoon.[1] Plaintiff, as a minority shareholder of Duma owes no fiduciary duty to Weatherspoon. *Priddy v. Edelman*, 883 F2d 438 (6th Cir., 1989) ("Minority shareholders owe no fiduciary duty to fellow shareholders.")

Furthermore, even if there was some fiduciary or some other special duty the Plaintiff owed Weatherspoon it would not be independent of Weatherspoon's status as a shareholder.

Accordingly based upon *Sabey*, Weatherspoon's counterclaim against plaintiff fails as a matter of law.

C. Plaintiff had no duty to disclose the terms of his employment contract to Weatherspoon.

Plaintiff's alleged fraudulent conduct was that he failed to disclose to Weatherspoon that his employment agreement contained a $160,000 bonus for completion of a FPGA H.264 decoder. (*See paragraphs 66 and 69 of Defendants' Answer to Third Amended Complaint.*) In order to prove a claim of fraud for failure to disclose a material fact

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[1] At the time of the alleged fraud plaintiff was no longer an employee or director of Duma Video.

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Weatherspoon must prove that Plaintiff had a duty to disclose based upon the nature of the parties relationship. *Favors v. Matzke*, 53 Wn. App. 789, 770 P.2d 686, review denied, 113 Wn.2d 1033, 784 P.2d 531 (1989).

> In Washington, the court will find a duty to disclose where the court can conclude there is a quasi-fiduciary relationship, where a special relationship of trust and confidence has been developed between the parties, where one party is relying upon the superior specialized knowledge and experience of the other, where a seller has knowledge of a material fact not easily discoverable by the buyer, and where there exists a statutory duty to disclose. *On the other hand, the rule has always been that silence as to material facts is not fraud where there is no duty to disclose*. *Id* at 796 (citations omitted; emphasis added.)

The existence of the duty is a question of law. *Id* at 796.

Plaintiff, as a minority shareholder of Duma does not owe a fiduciary duty to Weatherspoon. Furthermore there is no "special relationship of trust and confidence" between Plaintiff and Weatherspoon or reliance by Weatherspoon on Plaintiff's superior specialize knowledge.

By the time Weatherspoon first offered Duma for sale to BMS, each party had retained legal counsel to protect their rights in connection with their respective interests as shareholders, employees, and directors of Duma. Weatherspoon did not rely on Plaintiff's special knowledge in connection with the BMS transaction; in fact Weatherspoon was not talking with Plaintiff at the time of the transaction, except through emails and lawyers.

Finally, whatever relationship Plaintiff had with Weatherspoon it was in Weatherspoon's capacity as a representative of Duma, as its majority shareholder, director and president. Accordingly, if there was any duty to disclose, it would have been a duty to disclose to Duma itself, not to Weatherspoon, in his individual capacity. It is well settled that a corporation is a distinct entity from its shareholders. To find that Plaintiff had a duty to disclose the terms of his employment agreement to Weatherspoon, as an individual, would require the court to disregard Duma's corporate form, and would be contrary to the

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corporate laws of the State of Washington.

VI. CONCLUSION.

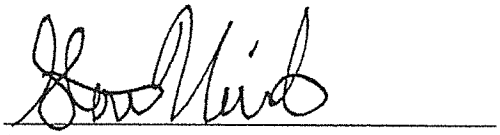
Duma has no standing to bring its counterclaims against Plaintiff because these claims were sold to BMS as part of the sale of its assets and thus Duma's counterclaims should be dismissed as a matter of law. Similarly, Weatherspoon, as a shareholder, has no standing to bring claims for fraud perpetrated against Duma and Weatherspoon's counterclaim fails because Plaintiff had no duty to disclose to Weatherspoon the terms of his employment contract. Therefore Weatherspoon's counterclaim should also be dismissed as a matter of law.

VII. PROPOSED ORDER

A proposed order granting the relief requested accompanies this motion.

Dated this 17th, day of March, 2014

TARLOW NAITO & SUMMERS, LLP



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DECLARATION OF SERVICE

I hereby certify that I served– **PLAINTIFF'S MEMORANDUM IN OPPOSITION DEFENDANT SULTAN WEATHERSPOON'S MOTION FOR SUMMARY JUDGMENT** on:

Michael R. Seidl
Seidl Law Offices PC
121 SW Morrison Street, Ste 475
Portland OR 97204
Attorney for Sultan Weatherspoon and Duma Video, Inc

By the following indicated method or methods:

☐ by **mailing** a full, true and correct copy in a sealed first-class postage prepaid envelope, addressed to the attorney(s) listed above, and deposited with the United States Postal Service at Portland, Oregon on the date set forth below.

☐ by **email** of a, true and correct copy to the attorney(s) listed above, at:

☒ by **hand delivering** a full, true and correct copy in a sealed envelope, addressed to the attorney(s) listed above, on the date set forth above.

I hereby declare that the above statement is true to the best of my knowledge and belief, and that I understand it is made for use as evidence in court and is subject to penalty for perjury under the laws of the State of Washington.

DATED: March 24, 2014.

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Scott G. Weber, Clerk, Clark Co.

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

FOR THE COUNTY OF CLARK

ALEX SAFRANSKI, an individual Plaintiff, v. DUMA VIDEO, INC., a Washington Corporation; and SULTAN WEATHERSPOON, an individual, Defendants.	**Case No. 12-2-02882-0** **DEFENDANTS' RESPONSE TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** **Hearing Date: April 18, 2014** **(Judge David E. Gregerson)**

INTRODUCTION

Plaintiff Alex Safranski refuses to deal with the real nature of defendants' counterclaims against him.

In his second Motion for Summary Judgment, Safranski argues that he should be permitted to deceive his fellow majority shareholder with impunity. He claims that defendant Sultan Weatherspoon cannot sue him, even if Safranski lied to him; and even if that lie misled Weatherspoon to sell assets for far less than those assets were actually worth.

Safranski argues that only defendant Duma Video can sue him for that lie. However, Safranski still claims he's home free, because the very transaction he fraudulently induced purported to transfer Duma's fraud claim to Broadcast Microwave Services, Inc. ("BMS").

Both of these arguments are factually and legally incorrect.

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Defendant Weatherspoon has an individual claim of fraud against Safranski. There is no "special relationship" requirement because Safranski induced the asset sale transaction by an active misrepresentation by half-truth.

Moreover, the asset sale transaction did not convey the corporation's counterclaims to BMS. Only causes of action that related to Duma's business, as defined by the APA, were transferred to BMS. That did not include a claim unknown to Duma that it had been fraudulently induced by Safranski's Employment Agreement with BMS to enter the APA in the first instance.

DUMA'S FIRST SUMMARY JUDGMENT

For his factual record supporting this Motion, Safranski relies upon the evidence he submitted in support of an earlier motion for summary judgment. In response to that motion, Duma filed an extensive factual record. That factual record is likewise relied upon the defendants in opposing this Motion for Summary Judgment.

However, during the interim between these two motions, Duma amended its counterclaims to add more clarity. Duma continues to assert counterclaims of breach of fiduciary duty and fraud. The amendment, however, makes clear that Duma alleges that Safranski's conduct **induced** Duma to enter the Asset Purchase Agreement in the first instance. A Bench copy of Defendants' Answer and Counterclaims is submitted with this memorandum.

In addition, defendant Weatherspoon alleges a direct counterclaim against Safranski. Weatherspoon also relies upon the earlier factual record filed by Duma. For the Court's convenience, defendants are including Bench copy of defendants' factual memorandum.

Finally, defendants also rely upon the Declaration of Sultan Weatherspoon submitted herewith.

The Court denied Safranski's earlier motion on the grounds that the evidence submitted by defendants created material issues of fact under CR 56. Therefore, under that ruling, defendants' counterclaims are supported by evidence establishing triable issues of fact. The only issues for this new motion are discussed below.

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THE NATURE OF SAFRANSKI'S FRAUD

The factual record submitted by defendants supports the following facts, all of which could be found by a reasonable trier of fact:

Safranski and Weatherspoon met on April 26, 2012, and agreed to sell the company's assets, because the two of them were no longer working well together. Weatherspoon had already put out a feeler to one of Duma's largest customers, Broadcast Microwave Servicers, Inc. ("BMS") inquiring whether they would be interested in buying Duma's assets for $1.5 million.

Safranski and Weatherspoon agreed to retain an independent valuation expert to determine whether the $1.5 million purchase price was reasonable. They hired Naomi Derner, a local valuation expert. After performing a valuation study, Derner concluded that the $1.5 million purchase price was reasonable for Duma's assets.

Safranski and Weatherspoon understood from the outset that BMS wanted both of them to work for BMS after the asset sale. That was because Duma had a key project under development that BMS wanted to have completed as part of the asset sale. That project was the completion of an H.264 decoder. The decoder was needed to complement Duma's H.264 encoder. The encoder was of little use to BMS without the decoder.

In their April meeting, Safranski and Weatherspoon agreed that neither of them should engage in private negotiations with BMS over employment while Duma was attempting to reach the best possible deal with BMS. The parties recognized that individual negotiations over employment terms might prejudice the negotiations between Duma and BMS.

On June 5, 2012, BMS made its first offer to Duma in a Letter of Intent ("LOI"). Under the terms of that proposed asset sale, BMS would pay Duma $1.2 million in two distinct payments. BMS would pay Duma $600,000 in guaranteed cash upon closing the transaction. BMS would pay Duma an additional $600,000 when Duma completed the H.264 decoder. As expected, the LOI included a term that both Safranski and Weatherspoon would work for BMS

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after the asset sale at the same rate of pay. The two of them would then complete Duma's work on the H.264 decoder project.

While Duma was considering and formulating its response to that LOI, Safranski did two things. First, he reneged on his April 26, 2012, agreement not to have discussions with BMS about his employment. Safranski went ahead and privately negotiated terms of employment with BMS. Those terms did not mention or include any bonus for completing the H.264 decoder.

Safranski's lawyer Mr. Naito, knowing that this negotiation violated the earlier agreement, disclosed Safranski's private negotiation to Weatherspoon's attorney. Weatherspoon objected, but nonetheless proceeded on Safranski's promise not to have any further contact.

Secondly, Safranski decided to play hardball and engage in economic coercion. Safranski threatened that he would not work for BMS unless Weatherspoon agreed to increase his percentage ownership in Duma from 20% to 45%. Weatherspoon rejected this act of coercion.

Safranski then resigned his employment with Duma and resigned his position as a Duma director. He did so as an obvious subterfuge, believing that by doing so he could escape his fiduciary duties as an employee and director. As the Court ruled in the earlier motion for summary judgment, the law extends fiduciary duties beyond resignation under such circumstances. But Safranski did not know this.

Safranski and BMS then engaged in a deceitful act. Although they discussed terms of employment, they also discussed something beyond mere employment. In addition to employment, Safranski and BMS agreed that Safranski would be paid $160,000 for completing Duma's project to develop the H.264 decoder. This was not, of course, a term of employment, even though it was included within an Employment Agreement as a subterfuge.

Safranski and BMS intentionally decided to keep this discussion secret, and conceal the $160,000 payment from Weatherspoon. Safranski needed Weatherspoon to sell Duma's assets to BMS in order for Safranski to complete the H.264 decoder and be paid $160,000. That is because the H.264 decoder would be based upon source code and other IP that was owned by

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Duma. If Duma did not agree to sell its assets, Safranski would have no way to secure this very handsome payment for himself.

By June 17, 2012, Weatherspoon informed BMS the negotiations had to be terminated because Safranski would not go to work for BMS. Safranski had told Weatherspoon he had accepted other employment with a different employer. This was untruthful.

With a deal in place for Safranski to develop the H.264 decoder, BMS made a second purchase offer. On June 27, 2012, BMS sent a second Letter of Intent, this time changing the payment terms. In order to appear to sweeten the pot for Weatherspoon, BMS offered to pay $900,000 in cash, and reduce the contingent payment for the H.264 decoder to $350,000. Of course, BMS did not explain that this change was made because they had a deal in place with Safranski to obtain the H.264 decoder for $160,000 (much less than the $350,000 contingent payment under the Letter of Intent).

As he had done with all negotiations with BMS, Weatherspoon conveyed this second Letter of Intent to Safranski. Despite being fully apprised of this purchase offer, Safranski did not disclose that he had already agreed to complete the H.264 decoder project for $160,000.

Based on the half-truths including that Safranski had gone to work for another firm, and without knowing the full truth about the BMS deal, Weatherspoon was induced to enter the Asset Purchase Agreement on August 17, 2012. Weatherspoon states in his Declaration that if Safranski had informed him the $160,000 agreement, he would not have agreed to enter into the APA.

Fundamentally, the $160,000 deal between Safranski and BMS dramatically altered the risk that Weatherspoon was accepting under the APA. Weatherspoon agreed to complete the H.264 decoder on behalf of Duma as an independent contractor. This involved a known risk that Weatherspoon would not be able to complete an H.264 decoder. However, because BMS depended on an H.264 decoder for its own business plans, Weatherspoon could be confident that

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whatever obstacles arose in the project, BMS would cooperate and accommodate Weatherspoon until the decoder project was finally completed.

With the Safranski deal in place, that risk of nonpayment of the Earnout was radically increased. The Safranski deal effectively set up a "race" between Safranski and Duma for the completion of the H.264 decoder. Safranski had several advantages, but the largest advantage was price. If Safranski could complete the H.264 decoder, BMS would only pay $160,000. BMS was, thus, economically incentivized to make sure that Safranski won the race.

If that risk had been known, Weatherspoon never would have entered the race to begin with. He would have kept the assets of Duma Video. The working relationship issues with Safranski were resolved by Safranski's resignation. Safranski agreed that the Duma assets were worth at least $1.5 million. Weatherspoon would have found another purchaser, and in the meantime continued to receive Duma's profits. Duma's track record of profitability had been impressive.

The race between Safranski and Weatherspoon to complete the H.264 decoder for BMS played out exactly as BMS and Safranski planned. By the spring of 2013, both Safranski and Weatherspoon had a prototype for the H.264 decoder. Weatherspoon's project involved some additional complications because the decoder needed to utilize an i7 Intel processing chip. Safranski's version of the H.264 decoder was somewhat simpler to develop.

By the summer of 2013, Weatherspoon's prototype i7 H.264 decoder had improved, and plans were in place to complete the project. However, Safranski won the race by providing BMS with an FPGA H.264 decoder that BMS chose to accept and pay Safranski $160,000.

BMS, not surprisingly, then rejected Weatherspoon's H.264 decoder, even though the prototype had significantly improved, and there was no reason to believe it could not have been completed. BMS refused to pay the Earnout, having already acquired Safranski's H.264 decoder.

When confronted with a claim of fraud, BMS agreed to enter a settlement and pay Duma $139,000.

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DUMA DID NOT SELL ITS CLAIMS AGAINST SAFRANSKI TO BMS

Safranski argues that Duma has no "standing" to sue him for fraudulently inducing Duma to enter the APA. Safranski is wrong.

Initially, it should be noted that Duma had no way of knowing about this fraud claim at the time the APA was entered. That is the very nature of Duma's claim – it was fraudulently induced to enter the APA because Safranski had made only a partial disclosure – or half-truth regarding his employment. Duma did not know about the $160,000 deal.

Therefore, there is no evidence that Duma knowingly transferred its counterclaims against Safranski. Nonetheless, Safranski claims that Duma's unknown counterclaims were sold.

The absurdity of this result must be recognized. Safranski claims that he and BMS could conspire to induce Duma to sell its assets, including any claims that were known or unknown. If successful, Safranski and BMS would then escape any liability for its fraud because the transaction would put the fraud claim beyond the reach of its victims, Weatherspoon and Duma Video. Obviously, BMS was not going to sue itself for fraudulent inducement, any more than BMS would sue its co-conspirator and employee Alex Safranski.

This result is not only absurd, it is legally incorrect.

First, Safranski attempts to enforce the terms of an agreement to which he is not a party. Safranski does not claim – nor could he establish – that he is third-party beneficiary to the APA. Ironically, then, it is Safranski who lacks standing to allege this affirmative defense of "lack of standing."

The transfer of the seller's claims as part of an asset sale is designed to give the buyer the right to pursue claims in the name of the seller. Thus, for example, if a customer owed money to Duma prior to the asset sale, BMS acquired that claim and the right to sue Duma's customer to recover such debt.

Second, the APA did not transfer <u>all</u> causes of action that Duma owned at the time of the APA.

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Rather, under Section 2.01(g) of the Asset Purchase Agreement, the term "Purchased Assets" is defined to include "all rights to any Actions." However, in order for a cause of action to qualify as an "Action," Section 2.01(g) requires that it be "related to the Business, the Purchase Assets or the Assumed Liabilities..."

The term "Business" is defined as "the business of video, audio and data compression, including encoding and decoding (the 'Business')."

Safranski assumes, without discussion, that "Duma's claims against Plaintiff for fraud and breach of fiduciary duty all relate to the Business and therefore have been sold to BMS." Safranski Memo. at p. 4.

In fact, there is nothing about Duma's counterclaims for fraudulent inducement and breach of fiduciary duties that relate to Duma's "Business" of data compression as defined by the APA. Duma's counterclaims against Safranski relate to the secret agreement made between Safranski and BMS. The claim relates to the Employment Agreement between Safranski and BMS. The counterclaims have nothing to do with "the business of video, audio and data compression, including encoding and decoding." Indeed, Duma could have been in the business of making hamburgers, and the same counterclaims would have been available against Safranski. The core subject of the counterclaims is a fraud perpetrated by both Safranski and BMS to induce an act by Weatherspoon.

Therefore, Safranski is not entitled to use the APA as a defense to his fraudulent inducement. Not only is Safranski's argument incorrect under the express terms of the APA, permitting Safranski to avoid liability for this conduct would be legally reprehensible. He cannot use the very terms of an agreement that he fraudulently induced to shield himself from liability from that fraudulent inducement. If Weatherspoon would not have entered the APA but for Safranski's fraudulent act, Duma's rights cannot be extinguished by a contract that would not have existed but for the fraud.

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WEATHERSPOON HAS A DIRECT CLAIM AGAINST SAFRANSKI

Safranski argues that Weatherspoon cannot sue him for fraudulently inducing Weatherspoon to enter the APA. Again, Safranski is wrong.

Safranski argues, "In order to prove a claim of fraud for failure to disclose a material fact, Weatherspoon must prove that Plaintiff had a duty to disclose based upon the nature of the parties' relationship." Weatherspoon relies upon *Savey v. Howard Johnson*, 101 Wn. App 575, 5 P.3d 730 (2000) to argue that Weatherspoon does not have standing to sue for fraud because Safranski did not owe Weatherspoon a "special duty." Both of these related arguments are wrong.

First, the *Savey* decision involved a claim of negligence by a sole shareholder against a third party. The defendant contended that only the corporation could sue the defendant for negligence. The appellate court examined the existence of a duty under negligence law. The issue in *Savey* concerned whether the element of duty under a claim of negligence could be asserted by a shareholder against a third party who provided services only to the corporation.

This case is not a claim of negligence that requires the existence of a duty. The claim of fraud does not contain "duty" as an element of the claim.[1] In effect, every person or entity is legally prohibited from defrauding another person or entity. As long as the elements of fraud are met (namely, a material misrepresentation that the plaintiff relies upon to his detriment), any person is liable for fraud to the victim of fraud.

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[1] A plaintiff claiming fraud must prove each of the following nine elements:

> (1) representation of an existing fact; (2) materiality; (3) falsity; (4) the speaker's knowledge of its falsity; (5) intent of the speaker that it should be acted upon by the plaintiff; (6) plaintiff's ignorance of its falsity; (7) plaintiff's reliance on the truth of the representation; (8) plaintiff's right to rely upon it; and (9) damages suffered by the plaintiff.

Stieneke v. Russi, 145 Wash.App. 544, (2008).

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Therefore, the *Savey* case is simply inapplicable. Safranski makes a related but distinct argument that also uses the concept of "duty," but in a different context. He conflates the two arguments without discussing the distinction.

Plaintiff relies upon fraud cases in which the defendant had remained completely silent as to a material fact. When one party remains completely silent about a material fact, the plaintiff claiming fraud generally must establish a "duty to disclose" the material fact in order to meet the required element of a misrepresentation of material fact.

In Washington, a duty to disclose is most commonly satisfied by a fiduciary duty, or special relationship of some kind "where one party is relying upon the superior specialized knowledge and experience of the other..." *Favors v. Matzke*, 53 Wn.App 789, 770 P.2d 683, rev. den., 113 Wn.2d 1033, 784 P.2d 531 (1989). That is true.

Safranski argues that "Plaintiff, as a minority shareholder of Duma does not owe a fiduciary duty to Weatherspoon. Furthermore, there is no 'special relationship of trust and confidence' between Plaintiff and Weatherspoon or reliance by Weatherspoon on Plaintiff's superior specialized knowledge." Safranski Memo. at p. 7.

Safranski's argument misses the point, however. This is not a case in which Safranski was completely silent. Safranski made a series of misrepresentations by half-truth during the negotiations leading up to the APA: He would not talk to BMS; he was going to work for another firm; he would not disclose Duma's trade secrets or confidential information. When such misrepresentations by half-truth are made, the "duty to disclose" is satisfied without the existence of a fiduciary or special relationship.

What Safranski did not tell Weatherspoon is that he had made the $160,000 deal with BMS to complete the H.264 decoder project, using Duma confidential business information and trade secrets.

"[W]hen a party makes a partial disclosure, the party then has a duty to tell the whole truth." 37 Am.Jur.2d, 'Fraud and Deceit,' §203. Under Washington law, a party has a "duty to

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speak... where only a partial disclosure is made...." *Gilliland v. Mt. Vernon Hotel Co.*, 51 Wn.2d 712, 717, 321 P.2d 558 (1958).

In *Ikeda v. Curtis*, 43 Wn.2d 449, 261 P.2d 684 (1953), the court described the general rule:

> We held in *Perkins v. Marsh*, 178 Wn. 362, 36 P.2d 689, 690, that, under certain circumstances, there is a duty to disclose a material fact even when there is no fiduciary relationship, saying:
>
> > It is true that, in the absence of a duty to speak, silence as to a material fact does not of itself constitute fraud. *Farmers State Bank of Newport v. Lamon*, 132 Wa. 369, 231 P. 952, 42 A.L.R. 1072. However, the concealment by one party to a transaction of a material fact within his knowledge, which it is his duty to disclose, is actual fraud. If appellants intentionally concealed some fact known to them, which it was material for respondents to know, that constituted a fraudulent concealment; that is, the concealment of a fact which one is bound to disclose is the equivalent of an indirect representation that such fact does not exist, and differs from direct false statement only in the mode by which it is made.
>
> Fraudulent misrepresentation may be effected by half-truths calculated to deceive. A representation literally true is actionable if used to create an impression substantially false.

37 C.J.S., 'Fraud,' §17b, p. 251.

In *Associated Indemnity Corp. v. Del Guzzo*, 195 Wa. 486, 81 P.2d 516 (1938), the court stated the rule this way:

> As to the duty of appellant to fully advise respondent as to the facts, the text found in 27 C.J., titled 'Fraud,' p. 1074, §17, is of interest, the rule being laid down that 'the duty to speak may arise from partial disclosure, the speaker being under a duty to say nothing or to tell the whole truth. One conveying a false impression by the disclosure of some facts and the concealment of others is guilty of fraud, even though his statement is true so far as it goes, since such concealment is in effect a false representation that what is disclose is the whole truth.'

Thus, Safranski is wrong that Weatherspoon must establish a fiduciary relationship in order to sue him for fraud. In this case, the evidence supports the fact that Safranski made

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misrepresentations to Weatherspoon by half-truth. Those half-truths induced Weatherspoon to enter the APA, and Weatherspoon is entitled to sue Safranski for that misrepresentation.

CONCLUSION

Defendants respectfully request the Court to deny plaintiff's motions for summary judgment.

DATED: April 8, 2014

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By: _____

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Attorney for Defendants

DECLARATION OF SERVICE

I hereby certify that I served the attached **DEFENDANTS' RESPONSE TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT** on the following person(s) on the date indicated below:

Steve L. Naito
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by the following indicated method(s):

☐ by **faxing** a full, true, and correct copy thereof to said attorney to the fax number noted above, which is the last known fax number for said attorney, on the date set forth below.

☒ by **emailing** a full, true, and correct copy thereof to said attorney to the email address noted above, which is the last known email address for said attorney, on the date set forth below.

☐ by notice of electronic filing using the E-filing system (LGR 30).

☒ by causing a full, true, and correct copy thereof to be **hand delivered** to the attorney at the attorney's last-known office address listed above on the date set forth below.

I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED: April 8, 2014

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FILED
2014 APR 14 PM 4:40
SCOTT G. WEBER, CLERK
CLARK COUNTY

IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF CLARK

ALEX SAFRANSKI, an Individual, Plaintiff, v. DUMA VIDEO, INC., a Washington Corporation, and Sultan Weatherspoon, an Individual, Defendants.	Case No. 12-2-02882-0 **PLAINTIFF'S REPLY MEMORANDUM IN SUPPORT OF HIS MOTION FOR SUMMARY JUDGMENT** **(Judge Gregerson)**

A. Duma Video sold its counterclaims to Broadcast Microwave Services Inc.

The issue before the Court is whether defendant Duma Video, Inc. ("Duma") sold its counterclaims to BMS pursuant to the August 17, 2012 Asset Purchase Agreement (the "APA"). Thus the question before the Court is what "Actions" did the parties to the APA intend to sell to BMS under Section 2.01 (g):

> (g) all rights to any Actions of any nature available to or being pursued by Seller to the extent *related to the Business, the Purchased Assets or the Assumed Liabilities*, whether arising by way of counterclaim or otherwise; (Emphasis Added.)

Defendants argue that Duma's counterclaims do not relate to Duma's "Business" as defined in the APA and therefore it is not an "Action" that was sold. The assigned "Actions" include more than just those related to the Business and include "any Actions of any nature available to …Seller to the extent related to the Business, the Purchased Assets or

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the Assumed Liabilities." Section 2.01 (g) of the APA.

Defendants assert that the counterclaims "[r]elate[ ] to the secret agreement made between Safranski and BMS." *Defendants' Memorandum, p. 8; lines: 12-13.* The so called "secret agreement" was that plaintiff would get paid $160,000 if he successfully developed a FPGA H.264 decoder. But Duma had started work on the FPGA H.264 decoder prior to the sale and it therefore was part of the intellectual property that was included in the sale. *Sultan Weatherspoon Deposition dated November 12, 2013 p. 9, Exhibit 1 to the Declaration of Steven L. Naito filed herewith ("Naito Declaration").* Thus the "secret agreement" was related to Duma's Business and the Purchased Assets. Defendants also claim the "core subject" of the counterclaims "is a fraud perpetuated by both Safranski and BMS to induce Weatherspoon to act." *Defendants' Memorandum, p. 8; lines: 17-18.* But the "act" in question was Duma entering into the APA, which again related to the Business, the Purchased Assets and the Assumed Liabilities.

There are no words limiting the "related to" phrase in Section 2.01(g), such as "related to sales of products sold by the Business" or "related to contract rights arising from the Business." The "related to" clause is unrestricted. The term "Actions" is likewise unlimited and included Actions of "any nature."

The definition of Purchased Assets in Section 2.01 is all inclusive:

> Section 2.01 **Purchase and Sale of Assets**: Seller shall sell, assign, transfer, convey and deliver to Buyer, and Buyer shall purchase from Seller ... all of Seller's right title and interest in, to and under *all* of the assets, properties and rights of every kind and nature, whether real, personal or mixed, tangible or intangible (including goodwill) wherever located and whether now existing or hereafter acquired (*other than the Excluded Assets*), which relate to, are used or held for use in connection with, the Business (collectively, the "Purchased Assets"), including, without limitation, the following:
>
> [Clauses a-l included all accounts receivable, all inventory, all contracts, all intellectual property, all personal property, all permits, all Actions, all

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prepaid expenses, all warranties, all insurance benefits, all books of account, and all goodwill.]

Thus virtually every asset, tangible and intangible, owned by Duma was included in "Purchased Assets."

Then in Section 2.02 specific assets are excluded from the sale:

> Section 2.02 Excluded Assets: Notwithstanding the foregoing, the Purchased Assets shall not include the following assets (collectively, the "Excluded Assets"):
>
> (a) all cash and cash equivalents held by Seller as of the Closing Date;
>
> (b) the Contracts specifically set forth on Section 2.02(b) of the Disclosure Schedules (the "Excluded Contracts");
>
> (c) the corporate seals, organizational documents, minute books, stock books, Tax Returns, books of account or other records having to do with the corporate organization of Seller;
>
> (d) all Benefit Plans and assets attributable thereto; and
>
> (e) the rights which accrue or will accrue to Seller under the Transaction Documents.

Thus the structure of the APA is to include all assets within the definition of Purchased Assets in Section 2.01 but then to exclude specifically identified assets in Section 2.02. If the parties had intended to exclude the counterclaims they would have been listed in Section 2.02. This conclusion is further supported by Section 2.04 (o), which describes one of the Excluded Liabilities:

> (o) any Liabilities arising out of matters relating to Mr. Alex Safranski as a shareholder or employee of Seller, including but not limited to those matters addressed in the complaint captioned Safranski v. Sultan Weatherspoon and Duma Video, Inc., Case No. 12-2-02882-0 filed in the Superior Court for the State of Washington, County of Clark (the "Safranski Matters").

The parties knew that plaintiff had sued defendants and the APA explicitly excluded the Safranski Matters from the liabilities being assumed by BMS. Because Safranski liabilities were explicitly excluded, it is reasonable to assume that had the parties intended to exclude

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the counterclaims, they would have similarly explicitly excluded them in Section 2.02 from the Actions being sold to BMS. But this was not done.

Defendants also claim that because they did not know of the existence of the $160,000 project bonus at the time of the sale they could not have intended to sell the counterclaims. However, the definition of "Actions" is not qualified to exclude unknown claims. Section 2.01 (g) provides that Purchased Assets include, without any limitation: "all rights to any Actions ...." In fact all of the clauses in Section 2.01 (a) – (l) (except clause (k)) that list categories of assets that are being sold include the word "all," which further signifies the all-inclusive nature of Section 2.01. Had the parties intended to exclude unknown Actions, they would have listed them in Section 2.02 Excluded Assets.

In addition, Duma knew of the existence of other claims against plaintiff prior to the asset sale. On June 1, 2012, Michael Seidl sent an email to Steve Naito stating: "Any claims or contentions regarding Alex's contact with BMS are suspended and reserved." *Exhibit 2 to Naito Declaration.* And in its first Answer filed on September 6, 2012 (three weeks after the closing of the APA), Duma filed its first counterclaim against plaintiff.[1]

Based upon the broad unrestricted "related to" language in Section 2.01 (g), the failure to list the counterclaims as an Excluded Asset in Section 2.02, the specific exclusion of the Safranski Matters from the Assumed Liabilities, and the fact that Duma knew it had claims against plaintiff when it signed the APA, this Court should find that, as a matter of law, the counterclaims were sold to BMS, and defendants have no standing to bring these claims.

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[1] In *Berg v. Hudesman*, 115 Wash 2d 657, 801 P2d 222 (1990), the Washington Supreme Court adopted the context rule of contract interpretation that allows the parties to introduce extrinsic evidence to interpret the intent of the parties. In this case there is no factual disputes regarding the interpretation of the APA and therefore the Court construes the contract as a matter of law.

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B. Defendants' argument that plaintiff lacks standing to raise its standing argument is without merit.

Defendants argue because plaintiff is not a party to the APA he has no standing to assert that Duma has sold the counterclaims to BMS. Defendants previously moved for summary judgment against plaintiff's derivative claims on the grounds that Duma had sold those claims to BMS pursuant to Section 2.01(g) (relating to the sale of all Actions to BMS) and the Court granted defendants' motion. Thus defendants are bound by the ruling that BMS owns all of Duma's "Actions." Pursuant to CR 17(a), all actions must be brought in the name of the real party in interest[2]. Plaintiff's standing argument is in effect an argument that Duma is not the real party in interest and Plaintiff has "standing" to raise CR 17(a) as a defense.

C. Plaintiff's argument does not leave Duma Video without a remedy.

Duma writes:

> "The absurdity of this result [that Duma sold its counterclaims] must be recognized. Safranski claims that he and BMS could conspire to induce Duma to sell its assets, including any claims that were known or unknown. If successful, Safranski and BMS would escape liability for its fraud because the transaction would put the fraud claim beyond the reach of its victim, Weatherspoon and Duma Video." *Defendants' Memorandum, p. p. 7 lines 10-14.*

Duma specifically excluded from the sale (as an Excluded Asset) the "rights which

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[2] In *Sprague v. Sysco Corp.*, 97 Wn. App. 169, 982 P.2d 1202, 1999 Wash. App. LEXIS 1596 (Wash. Ct. App. 1999) the Court of Appeals said:

> CR 17(a) is identical to Federal Rule of Civil Procedure 17(a). Thus, analysis of the federal rule may be looked to for guidance and followed if the reasoning is persuasive. See Beal v. City of Seattle, 134 Wn.2d 769, 777, 954 P.2d 237 (1998).
>
> The modern function of the rule is "to protect the defendant against a subsequent action by the party actually entitled to recover, and to insure generally that the judgment will have its proper effect as res judicata." FED. R. CIV. P. 17(a) advisory committee's note to 1966 amendment.

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accrue or will accrue to Seller under the Transaction Documents." Section 2.02 (e). Thus, Duma retained any claims against BMS arising under the Transaction Documents, which would include the alleged claim for fraudulent inducement. No similar carve-out was reserved for claims against plaintiff. Furthermore, defendants admit that: "When confronted with a claim of fraud, BMS agreed to enter a settlement and pay Duma $139,000. *Defendants' Memorandum, p. 6; lines: 25-26.*

D. Defendant Weatherspoon has no standing to bring his counterclaim for fraud against Plaintiff.

Plaintiff previously cited *Sabey v. Howard Johnson & Co.*, 101 Wn App 575, 5 P3d 730 (2000), for the rule that a shareholder does not have standing to sue for wrongs to a corporation except in limited circumstances. Accordingly Weatherspoon, as a shareholder of Duma, does not have standing to sue plaintiff for wrongs to Duma. Weatherspoon distinguishes *Sabey* on the grounds that the plaintiff in *Sabey* brought a negligence claim against a third party whereas Weatherspoon's claims are in fraud.

> The appellate court examined the existence of a duty under negligence law. The issue in Sa[b]ey concerned whether the element of duty under a claim of negligence could be asserted by a shareholder against a third party who provided services only to the corporation.
>
> This case is not a claim of negligence that requires the existence of a duty. The claim of fraud does not contain "duty" as an element of the claim. ...
>
> Therefore, the Sa[b]ey case is simply inapplicable.
>
> *Defendants' Memorandum, p 9; lines: 9-16; p.10; line:1.*

Weatherspoon completely misreads *Sabey*. Weatherspoon argues because his fraud claim is not based upon any duty plaintiff owed him, that *Sabey* is inapplicable and Weatherspoon has standing to sue plaintiff for a wrong to Duma. *Sabey* in fact held the opposite – a shareholder cannot sue a third party for a wrong to the corporation unless the third party owed a special duty to the shareholder.

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In *Sabey*, the plaintiff was an investor who purchased Fredrick and Nelson Acquisition Company through his wholly owned company, Sabey Corporation. Prior to the acquisition, he communicated (through his attorney) with defendant Howard Johnson & Company (HJC), an actuarial firm retained by FNAC, to assist it in phasing out its pension plan. HJC advised Sabey's attorney that the pension plan assets were sufficient to terminate the plan without a significant deficiency. Sabey then acquired FNAC through Sabey Corporation. Subsequently, FNAC went bankrupt and the Pension Benefit Guaranty Corporation (PBGC) brought claims against Sabey and Sabey Corporation, as members of the "control group" under ERISA for FNAC's underfunded pension liabilities. Sabey settled with PBGC by paying $1.95 million for his and Sabey Corporation's release and Sabey then sued HJC for negligence, negligent misrepresentation and indemnity based upon the erroneous advice given about the pension plan assets.

The trial court granted HFJC's summary judgment against Sabey, in part, because Sabey, as an individual shareholder, lacked standing to bring claims for wrongs to the corporation - in this case Sabey Corporation. The Washington Court of Appeals reversed the trial court's ruling, holding that Sabey met both exceptions to the general rule that a shareholder does not have standing to sue for a wrong to the corporation.

The two exceptions are: "(1) where there is a special duty, such as a contractual duty, between the wrongdoer and the shareholder; and (2) where the shareholder suffered an injury separate and distinct from that suffered by other shareholders." *Sabey*, 101 Wn App at 584-85. The Court of Appeals found that HJC owed a duty to Sabey personally based upon Restatement 2nd 552 (negligent misrepresentation) because HJC represented to Sabey's personal attorney that the plan was only minimally underfunded. And therefore because HJC had a duty to Sabey, he had standing to bring the action. In addition, the Court of Appeals found that Sabey had standing because his personal liability to the PBGC was "an

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injury separate and distinct from that of other shareholders." *Sabey*, 101 Wn App at 586.

Weatherspoon does not argue that he fits within either of the two exceptions. He has not introduced any evidence that he was owed a special duty by plaintiff and he has not introduced any evidence of an injury separate and distinct from that suffered by other shareholders. Accordingly, the general rule applies:

> Ordinarily, a shareholder cannot sue for wrongs done to a corporation, because the corporation is a separate entity: the shareholder's interest is viewed as too removed to meet the standing requirements. Even a shareholder who owns all or most of the stock, but who suffers damages only indirectly as a shareholder, cannot sue as an individual. *Id. at 584.*

Accordingly, Weatherspoon has no standing to bring his counterclaim.

E. Plaintiff had no duty to disclose the terms of his employment contract to Weatherspoon.

Weatherspoon has failed to cite any law or evidence that plaintiff, as a minority shareholder, owed him any fiduciary duties or any other type of special duty that would impose a duty upon plaintiff to disclose the terms of his employment agreement to Weatherspoon. Instead, Weatherspoon argues that this is not a case of silence but rather one of half truths.

> Safranski's argument misses the point, however. This is not a case in which Safranski was completely silent. Safranski made a series of misrepresentations by half-truth during the negotiations leading up to the APA: He would not talk to BMS; he was going to work for another firm; he would not disclose Duma's trade secrets or confidential information. When such misrepresentations by half-truth are made, the "duty to disclose" is satisfied without the existence of a fiduciary or special relationship.
>
> *Defendants' Memorandum, p. 10; lines: 16-21.*

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By definition, a half-truth is a true statement that leads the other party to believe a false situation exists.[3] The false impression alleged by Weatherspoon is that he did not know that plaintiff had entered into an employment agreement with BMS that contained a $160,000 project bonus to complete an FPGA H.264 decoder.[4] The alleged half truths – (1) that plaintiff would not talk to BMS, (2) that he was going to work for another firm, and (2) that he would not disclose Duma's trade secrets or confidential information – do not create a false impression that plaintiff was not getting the $160,000 bonus.

Furthermore, the first and second alleged half truths cited by defendants ((1) that plaintiff would not talk to BMS; and (2) that plaintiff was going to work for another firm) turn out to be untrue because plaintiff did talk with BMS and he did not go to work at another firm. But, in any event, these statements cannot be the basis of fraud claims because defendants knew that both statements were false prior to closing of the asset sale.[5] On May 30, 2012, plaintiff's lawyer disclosed to Weatherspoon's lawyer that plaintiff had been discussing employment with BMS. *Exhibit3 to Naito Declaration*. As to half truth (2), the APA itself disclosed that plaintiff was working at BMS and the closing was contingent on him continuing to work at BMS.

Weatherspoon does not allege that he would never have entered into the APA if he knew that plaintiff had talked to BMS or had not gone to work with a third party.

As to half truth (3), defendants cite no evidence that plaintiff ever represented that he

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[3] Weatherspoon cites *Ikeda v. Curtis*, 43 Wn.2d 449, 460, 261 P.2d 684 (1953) for the definition of a half-truth: "A representation literally true is actionable if used to create an impression substantially false." (*Citation omitted.*)

[4] Weatherspoon's claim is not that plaintiff failed to disclose that he had entered into an employment agreement with BMS because he knew in advance that BMS was going to hire him. See Section 7.03(j) to the APA, which made it a condition to buyer's obligation to close that plaintiff's employment arrangement was in full force and effect.

[5] One of the elements of a claim for fraud, whether by half-truth or otherwise, is that the defrauded party be ignorant of the falsity of the misrepresentation. *Stieneke v. Russi,* 145 Wash App 544, 190 P3d 60 (2008).

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would not disclose Duma's trade secrets or confidential information to any party[6] and they cite no evidence that plaintiff disclosed Duma's trade secrets or confidential information to any party, other than to BMS after it acquired all of Duma's intellectual property. Further, even if plaintiff made the representation to defendants that he would not disclose confidential information, it would not lead to the false impression that plaintiff would not negotiate an agreement to receive a $160,000 project bonus for building an FPGA H.264 decoder.

F. CONCLUSION.

The all-inclusive nature of the assets being sold pursuant to Section 2.01 of the APA must be read to include the counterclaims in the Actions that were to be sold to BMS, unless they were carved-out in Section 2.02 Excluded Assets. Because the counterclaims were not included as an Excluded Asset, they were sold to BMS and Duma has no standing (is not the real party in interest) to bring them and the Court should grant plaintiff's motion dismissing Duma's counterclaims with prejudice.

Weatherspoon makes no claim and cites no evidence that there is any special duty owed to him by plaintiff. Thus Weatherspoon cannot meet standing requirement of *Sabey* for a shareholder to bring an action for a wrong to the corporation and he cannot meet the duty to disclose requirement to prove fraud for non-disclosure. As shown above, Weatherspoon cannot rescue his fraud claim by changing his claim to fraud by half-truths. Therefore, the Court should grant plaintiff's motion dismissing Weatherspoon's counterclaims with prejudice.

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[6] Plaintiff had a duty not to disclose such information to third parties, but a breach of that duty does not give rise to a fraud claim. Furthermore, after the sale of Duma's assets (including Actions) to BMS, only BMS would have the right to bring a claim for improper disclosure.

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Dated this 14th, day of April, 2014

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DECLARATION OF SERVICE

I hereby certify that I served— –**PLAINTIFF'S REPLY MEMORANDUM IN SUPPORT OF HIS MOTION FOR SUMMARY JUDGMENT** on:

Michael R. Seidl
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121 SW Morrison Street, Ste 475
Portland OR 97204
Attorney for Sultan Weatherspoon and Duma Video, Inc

By the following indicated method or methods:

☐ by **mailing** a full, true and correct copy in a sealed first-class postage prepaid envelope, addressed to the attorney(s) listed above, and deposited with the United States Postal Service at Portland, Oregon on the date set forth below.

☐ by **email** of a, true and correct copy to the attorney(s) listed above, at:

☒ by **hand delivering** a full, true and correct copy in a sealed envelope, addressed to the attorney(s) listed above, on the date set forth above.

I hereby declare that the above statement is true to the best of my knowledge and belief, and that I understand it is made for use as evidence in court and is subject to penalty for perjury under the laws of the State of Washington.

DATED: April 14, 2014.

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Case Name: Safranski v. Weatherspoon, et al.

Court of Appeals Case Number: 47716-5

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