Supreme Court No. 92306-0
Court of Appeals No. 71405-8-I

**IN THE SUPREME COURT**
**OF THE STATE OF WASHINGTON**

THE SAGE GROUP I, LLC, a Washington limited liability company; M3, INC., a Washington corporation; RONALD WORMAN and SALLY WORMAN, individually and the marital community composed thereof; ERIK VAN ALSTINE, individually and his marital community,

Appellants,

v.

JOHN KOTTER and NANCY DEARMAN, individually and the marital community composed thereof; KOTTER ASSOCIATES, INC., a Massachusetts corporation; KOTTER INTERNATIONAL, INC., a Massachusetts corporation; SAGE | KOTTER, LLC, an inactive Delaware limited liability company,

Respondents.

# APPELLANTS' PETITION FOR REVIEW

David R. Goodnight, WSBA #20286
John E. Glowney, WSBA #12652
Rita V. Latsinova, WSBA #24447
Aric H. Jarrett, WSBA #39556
STOEL RIVES LLP
600 University Street, Suite 3600
Seattle, WA 98101
(206) 624-0900

Attorneys for Appellants

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

**Cases**

**Rules**



**Other Authorities**

## I. IDENTITY OF PETITIONERS

Petitioners, The Sage Group I, LLC, M3, Inc., Ronald and Sally Worman, and Erik Van Alstine, were plaintiffs in the trial court and appellants in the Court of Appeals.

## II. COURT OF APPEALS DECISION

Petitioners seek review of Division One's unpublished decision in *The Sage Group I, LLC, et al. v. Kotter, et al.*, No. 71405-8-I, filed on August 24, 2015, attached at Appendix ("**App.**") 1-21. That decision concludes that Washington courts are powerless to reach property obtained by fraud if it has been moved to an "innocent" transferee. That is not the law. Courts have imposed constructive trusts on property obtained by fraud for centuries. It has ***never*** mattered that trust property was changed into a new form, transferred to an "innocent" third party, or that its value was uncertain. By holding otherwise, the Court of Appeals provided a roadmap for wrongdoers and their allies to escape liability and deprive a defrauded party of a full remedy. Review and reversal are warranted.

## III. ISSUES PRESENTED FOR REVIEW

1. Whether an arbitration award in favor of a defrauded party ("Victim") and against the breaching fiduciary ("Fraudster") that ordered Fraudster to disgorge the profits he earned from the property obtained by that breach collaterally estops Victim's subsequent lawsuit for a constructive trust on the property itself, now held by an "innocent" transferee ("Snow White"), when Fraudster and Snow White colluded to

remove it out of the arbitrator's jurisdiction, and when Fraudster spoliated and Snow White withheld volumes of evidence relevant to the property.

2. Whether Snow White's business—which acquired, without consideration, substantially all of the assets and ongoing operations of the business Snow White shared with Fraudster—may contract around successor liability.

## IV. STATEMENT OF THE CASE

The facts are taken from the Court of Appeals' opinion, supplemented by the record on appeal.

### A. Factual Background

The Sage Group is a successful business consulting firm. Ron Worman ("**Worman**") and his wife, Sally (collectively, the "**Wormans**"), have been members of The Sage Group since 2002. Dana Green ("**Green**") and his wife had a membership interest in The Sage Group until 2010, when their interest was terminated. Erik Van Alstine is the president of M3. Green served on M3's Board of Advisors.

In fall 2007, Van Alstine introduced The Sage Group to Dr. John Kotter, a Harvard Business School professor and author. At that time, Kotter and his wife, Nancy Dearman (collectively, the "**Kotters**"), owned and operated Kotter Associates, a public-speaking and book-publishing business. On February 11, 2008, Kotter Associates and The Sage Group entered into a consulting agreement, which provided for monthly payments of $20,000 to The Sage Group in exchange for consulting services. CP 65-68.

In June 2008, Kotter proposed a new relationship with The Sage Group: "No consultant and client. All new revenue from joint activities is split by some formula." CP 259-61. Green, as the point person for The Sage Group's and Van Alstine's communications with the Kotters, agreed. *Id.* The new business, Sage|Kotter, LLC, was registered as a Delaware limited liability company in August 2008. The Sage Group, Worman, and Van Alstine were instrumental in getting that business started: Van Alstine worked with The Sage Group to create business plans and identify potential clients, including Westinghouse and the U.S. Army; Worman helped developed market strategy and identified the executive team. In October 2008, the Kotters proposed that they would own 51 percent of Sage|Kotter and "Dana [Green] and friends" would own 49 percent. CP 2051. The Kotters were "neutral" about Worman's and Van Alstine's ownership interest as long as it came out of Green's share. CP 1827-28.

In the last few months of 2008, however, Green started pursuing his own interests in Sage|Kotter. In December 2008, Worman received a proposed operating agreement that allocated 96 percent of the ownership of Sage|Kotter and 100 percent of the voting and management rights to Kotter and Green; Worman would receive a 4 percent non-voting interest and Van Alstine would receive nothing. CP 1608, 1635-36.

Over Worman's and Van Alstine's objections, Green and the Kotters executed Sage|Kotter's Operating Agreement, which allocated to them 38 percent and 62 percent of the ownership interests, respectively, and appointed Green and Kotter co-managers. CP 1173-220. Sage|Kotter

was immediately successful, generating more than $7,000,000 in revenues in 2009—a threefold increase over the revenues the Kotters had generated by themselves a year earlier. CP 1122-23, 1600, 1638, 2449. The majority of that revenue came from consulting services for clients such as Westinghouse and the U.S. Army. App. at 5-6; CP 1966-67, 2449.

As required by The Sage Group's Operating Agreement, the Wormans commenced an arbitration against Green in April 2009 for breach of fiduciary duty (the "**Arbitration**"). CP 271-312. They sought disgorgement of Green's salary as Sage|Kotter's president as well as a constructive trust over the 38 percent ownership interest in Sage|Kotter that he wrongfully obtained. *Id.* Because the Kotters, Kotter Associates, and Sage|Kotter were not parties to The Sage Group's Operating Agreement, they could not be joined to the Arbitration. Van Alstine and M3 filed a separate lawsuit against Green for breach of fiduciary duty arising out of the M3 Board Advisor Agreement.

Green and the Kotters coordinated their strategies in the Arbitration. CP 327. One strategy included dissolving Sage|Kotter:

> Section 9.5 [of Sage|Kotter's LLC Agreement] permits Class A and B members to purchase and transfer each other's units. However, doing this would not be in your clients' interests, because ***Mr. Worman or Mr. Van Alstine would surely join your clients in the arbitration/litigation to impose a constructive trust over Mr. Green's 38% ownership interest in Sage|Kotter***. Ultimately, nothing in the LLC Agreement requires Mr. Green to forfeit his units absent dissolution of Sage|Kotter. For that reason, we believe ***the formal dissolution of Sage|Kotter … is in the best interest of all of our clients.***

CP 2074 (emphasis added).

Under sections 5.6.3 and 5.6.5 of Sage|Kotter's Operating Agreement, "unanimous" consent of all managers (*i.e.*, Kotter and Green) was required to dissolve Sage|Kotter under section 12.2 of the Operating Agreement or to transfer its assets or business. *See* CP 728, 733, 736, 741-42. On December 22, 2009, the Kotters unilaterally announced that they had "voted and ... desire[d] to dissolve and wind up the affairs of [Sage|Kotter], pursuant to Section 12.2(a)(ii) of the Operating Agreement." CP 432-33, 435, 1618-19. On January 10, 2010, the Kotters and Green entered into a Settlement Agreement and Mutual Release (the "**Settlement Agreement**") under which Green received $31,250 in unpaid salary from Sage|Kotter (CP 1358); $129,639 for his share of some of Sage|Kotter's cash-on-hand (CP 1359); and $150,000 from the Kotters for a release of claims (CP 1349). None of the amounts Green received were for his 38 percent interest. CP 1335-36, 1520, 1792. No valuation was done of Sage|Kotter's assets or ongoing business.

The Settlement Agreement transferred all of Sage|Kotter's assets to Kotter International, Inc., a previously dormant company wholly owned by the Kotters. CP 1363-66, 1994. That transfer included all of Sage|Kotter's ongoing contracts under which more than $5,852,500 remained to be paid, and was paid to Kotter International. CP 1366. It also included the intellectual property that Sage|Kotter developed and used to perform those contracts. *See id.*; *see also* CP 1968. Kotter International stepped into the shoes of Sage|Kotter by continuing to provide the same services, under the same business model, to the same

clients, under the same contracts, through the same employees, in the same office space. CP 413-14, 417-19. The three contracts that generated 75 percent of Sage|Kotter's revenue became the largest sources of revenue for Kotter International, taking a "dormant" company with a few thousand dollars in revenue in 2009, to an active company with more than $8,950,000 in revenue in 2010. CP 1332, 1338, 1994. Neither the Kotters nor Kotter International paid any consideration to Sage|Kotter for the assets transferred to Kotter International. CP 1363-66, 1758, 1770, 1788.

Eight months after the "dissolution" of Sage|Kotter, the Arbitrator found Green liable to The Sage Group and the Wormans for constructive fraud and breaches of fiduciary duty. App. 24, 30. The Arbitrator also found that Green acquired his 38 percent ownership interest in Sage|Kotter wrongfully, *id.* at 24, and that Green tried to obscure his wrongdoing by "spoliation of hard copy and electronic records," *id.* at 26, and "by presenting sworn testimony that can only be viewed as knowingly incomplete and untrue," *id.* at 42. The Arbitrator ordered Green to disgorge half of the compensation he received from Sage|Kotter in 2009, or $413,562.50; half of the salary he received from The Sage Group for the last two months of 2008, or $34,320.50; and half of the "settlement payment" from the Kotters, or $75,000. *Id.* at 33-35. The Arbitrator also awarded the Wormans their attorneys' fees and costs. *Id.* at 45-46.

The Arbitrator, however, was unable to enforce the constructive trust on the 38 percent ownership interest. Because Sage|Kotter had been stripped of all assets and dissolved, and because the Arbitrator had no

jurisdiction over the Kotters or Kotter International, the Arbitrator was "prevent[ed] [from] the formal imposition of a trust." *Id.* at 40. The Arbitrator stated that, but for the transfer, a constructive trust "could have been imposed." *Id.* at 44. Although the Arbitrator found that the Wormans' alternative claim for the value of that interest was "speculative" based on the available evidence, *id.* at 31-33, 44, he nonetheless found that the 38 percent ownership interest was "valuable," *id.* at 31. The Arbitrator did not find that disgorgement provided the Wormans a complete remedy. *See generally id.* at 22-46.

In August 2011, the Wormans (and the other Petitioners) filed the action below against the Kotters, Sage|Kotter, and Kotter International seeking the complete remedy they were prevented from obtaining in the Arbitration. CP 1-61. Petitioners moved for partial summary judgment on their claims for constructive trust, successor liability, and alter ego. Respondents cross-moved for summary judgment, arguing that all of Petitioners' claims were barred by collateral estoppel. In November 2013, the trial court granted Respondents' motion and dismissed all of Petitioners' claims. CP 1905-15, 1947-51. It reasoned that the "remedy issue to be decided here is identical to the issue that [the Arbitrator] decided," and concluded that the Arbitrator's jurisdictional inability to impose a constructive trust precluded the court from imposing a constructive trust over the ownership interest wrongfully transferred from Green to the Kotters. CP 1907-08.

The Court of Appeals affirmed. App. at 21. It reasoned that "the 'ultimate facts' in both the Arbitration and [The] Sage Group's lawsuit against the Kotters involved the valuation of Green's 38 percent interest in Sage|Kotter," and that the Arbitrator's conclusion that the value of that interest was "speculative" barred the claim for constructive trust below. *Id.* at 12, 16. Petitioners seek review.

## V. ARGUMENT

### A. Summary of Argument

The Court of Appeals' decision abandoned more than a century of Washington law when it barred Petitioners from pursuing their claim for constructive trust on the 38 percent ownership interest in Sage|Kotter, which had been obtained by proven breaches of fiduciary duty and fraud, and which was traceable to the Respondents beyond any dispute. Collateral estoppel does not support this patently incorrect and inequitable result. The Court of Appeals cited absolutely no authority for its statement that a claim for constructive trust is dependent on "value." *Id.* at 12. This glaring omission points to a clear error: the law is settled that "value" is not an element of a constructive trust claim. Because a constructive trust claim does not depend on value, the Arbitrator's finding that the value of the 38 percent ownership interest was "speculative" did not collaterally estop Petitioners' claim in this action.

Petitioners were entitled to seek a constructive trust over the 38 percent ownership interest in Sage|Kotter in a court of general

jurisdiction not because it had a quantifiable value, but because Green had acquired it through breaches of fiduciary duty:

> [A] court of equity has jurisdiction to reach the property either in the hands of the original wrongdoer, or in the hands of any subsequent holder ... [T]hat a transferee was not the original wrongdoer does not insulate him from liability for restitution ... The constructive trust is based on property, not wrongs[.]

*Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238, 251, 120 S. Ct. 2180 (2000) (citations and quotation marks omitted).

Washington courts have followed this principle "without exception" for more than a century. *See Rozell v. Vansyckle*, 11 Wash. 79, 84, 39 P. 270 (1895); *Huber v. Coast Inv. Co.*, 30 Wn. App. 804, 810, 638 P.2d 609 (1981). Because a "'constructive trust is based on property, not wrongs,'" *Harris Trust*, 530 U.S. at 251 (citation omitted), Petitioners were entitled to pursue the property Green had obtained by fiduciary breach in the hands of its subsequent holder by enforcing the constructive trust. The Court of Appeals' erroneous theory of constructive trusts cut off that right, and limited the full equitable power of Washington courts to redress fiduciary breaches and protect trust beneficiaries. It warrants review under RAP 13.4(b)(1) and (2).

The Court of Appeals' mistaken emphasis on "value" also caused it to turn a blind eye to Green's spoliation of evidence and the Kotters' withholding of evidence that was central to Sage|Kotter's business in the Arbitration. App. at 16. In so doing, the Court of Appeals implicitly condoned deliberate, strategic discovery violations by breaching

fiduciaries and third parties. This presents an independent issue of substantial public importance that warrants review under RAP 13.4(b)(4).

Lastly, the Court of Appeals abandoned decades of Washington law when it refused to impose successor liability on a business that is a "mere continuation" of one that the breaching fiduciary had acquired by fraud. In so doing, the Court of Appeals provided a roadmap for wrongdoers and their allies to contract around successor liability. This error warrants review under RAP 13.4(b)(1) and (4).

### B. The Court of Appeals' Decision Conflicts with More Than a Century of Washington Common Law

When an officer or director breaches his fiduciary duty and acquires an advantage for himself, "the law charges the interest so acquired with a trust for the benefit of the corporation, ... [and] it denies to the betrayer all benefit and profit." *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939). The remedy for that breach has two independent components each serving a different purpose: disgorgement and restitution. "Disgorgement wrests ill-gotten gains from the hands of a wrongdoer." *Edmonson v. Lincoln Nat'l Life Ins. Co.,* 725 F.3d 406, 415 n.3 (3d Cir. 2013). Restitution compensates the victim by returning the property to its rightful owner. It is awarded "in the form of a constructive trust or an equitable lien, where ... property ... could clearly be traced to particular funds or property in the defendant's possession." *Great-W. Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 213, 122 S. Ct. 708 (2002). These two components are complementary: disgorgement of profits

earned from property obtained by a fiduciary breach is not a substitute for restitution in the form of a constructive trust over the property itself.

A constructive trust "arises immediately with [the] acquisition of the proceeds of the fraud." *United States v. $4,224,958.57*, 392 F.3d 1002, 1004 (9th Cir. 2004) (citing 5 Austin W. Scott, *The Law of Trusts: Scott on Trusts* § 462.4 (4th ed. 1989)); *see also Huber*, 30 Wn. App. at 810. Here, the constructive trust arose in January 2009, when Green breached his fiduciary duties by executing the Sage|Kotter Operating Agreement. App. at 24, 43-44.

A constructive trust is not defeated when the breaching fiduciary transfers trust property to a third party, unless the transferee is a bona fide purchaser.[1] The transferee

> takes the property subject to the trust, unless he has purchased the property for value and without notice of the fiduciary's breach of duty. The trustee or beneficiaries may then maintain an action for restitution of the property (if not already disposed of) or disgorgement of proceeds (if already disposed of), ***and*** disgorgement of the third person's profits derived therefrom.

*Harris Trust*, 530 U.S. at 250 (emphasis added) (citing Restatement (Second) of Trusts §§ 284, 291, 294, 295, 297 (1959)). Similarly, a constructive trust is not defeated by a change in the property's physical or corporate form. The trust "follow[s] property ... into its product." 1 Dan B. Dobbs, *Law of Remedies* § 4.3(2), at 592 (2d ed. 1993); *see also Winstandley v. Second Nat'l Bank of Louisville*, 41 N.E. 956, 957 (Ind. Ct.

[1] The Kotters and Kotter International are *not* bona fide purchasers: they had notice of Petitioners' claims, CP 1610-11, 1617, and paid "zero" for the ownership interest, CP 1792. *See Ryan v. Plath*, 18 Wn.2d 839, 863, 140 P.2d 968 (1943) (transferee-corporation not a bona fide purchaser where officers knew of breach of trust).

App. 1895) (it is an "ancient rule of the common law" that a person wrongfully deprived of his property "may follow it, and recover it, no matter what changes and transmutations it may have undergone"). Accordingly, "if logs be sawed into lumber, and the lumber be made into an article of furniture, the owner of the logs may recover the article of furniture." *Winstandley*, 41 N.E. at 957.

The changes in form and legal title are irrelevant because property obtained through a fiduciary breach remains subject to the constructive trust. "So long as either the original or substituted property can be traced or followed equity will always attribute the ownership to the beneficiary and will not allow the right to be defeated by the wrongful act of the fiduciary, no matter what form it may assume." *Fall v. Miller*, 462 N.E.2d 1059, 1062 (Ind. Ct. App. 1984) (internal quotation marks and citation omitted); *see also Demoulas v. Demoulas Super Mkts., Inc.*, 677 N.E.2d 159, 182-89 (Mass. 1997) (imposing constructive trust over diverted business opportunity notwithstanding stock transfers, mergers, reorganizations, and name changes).

Washington courts have followed these "universal" rules for more than a century. *Paysse v. Paysse*, 86 Wash. 349, 354, 150 P. 622 (1915) (citing 3 *Pomeroy's Equity Jurisprudence* § 1048 (3d ed.)). They have held, "without exception," that where property subject to a constructive trust is transferred to a third party, the transferee holds the property subject to the constructive trust. *Rozell*, 11 Wash. at 84; *see also Huber*, 30 Wn. App. at 810. For almost as long, Washington courts have

recognized separate claims and remedies against a breaching fiduciary and third-party transferees where the former disposed of trust property. *See, e.g., Tucker v. Brown*, 20 Wn.2d 740, 777, 150 P.2d 604 (1944); *Glasgow v. Nicholls*, 124 Wash. 281, 288, 214 P. 165 (1923).

The Court of Appeals' decision disregarded each of these principles when it barred Petitioners from pursuing their claim for constructive trust for 38 percent ownership interest in Sage|Kotter, which had been obtained by proven breaches of fiduciary duty and which was traceable beyond any dispute to Respondents. The principles of collateral estoppel do not support this result. "Collateral estoppel is confined ... to situations where the matter raised in the second suit is ***identical in all respects*** with that decided in the first proceeding and where the ***controlling facts and applicable legal rules remain unchanged.***" *Standlee v. Smith*, 83 Wn.2d 405, 408, 518 P.2d 721 (1974) (internal quotation marks and citation omitted; emphasis added). Collateral estoppel is further limited to "***ultimate*** ... ***facts directly at issue*** in the first controversy ***upon which the claim rests.***" *Beagles v. Seattle-First Nat'l Bank*, 25 Wn. App. 925, 931, 610 P.2d 962 (1980) (emphasis added).

The value of the 38 percent ownership interest in Sage|Kotter was neither an "ultimate fact" in the Arbitration nor presented an "identical" issue in the action below. The specific value of that interest was irrelevant to the Arbitrator's order that Green disgorge part of the salary and benefits he received from Sage|Kotter. Disgorgement is measured by the wrongdoer's profits rather than the victim's loss and does not require

proof of value. *See Eriks v. Denver*, 118 Wn.2d 451, 462, 824 P.2d 1207 (1992); *see also* Restatement (Third) of Restitution and Unjust Enrichment § 51 cmt. a (2011); *id.* § 43 cmt. d (a claim based on a breach of the duty of loyalty may be brought "without regard to economic injury"). Because disgorgement does not depend on a determination of value, the Arbitrator's finding that the value of the 38 percent ownership interest was speculative was not necessary to the remedy awarded by the Arbitrator and, therefore, is not an "ultimate fact" to which collateral estoppel applies. *See Beagles*, 25 Wn. App. at 930 ("[F]indings made in the first action on which the judgment is not dependent are not conclusive between the parties in a subsequent action." (citing Restatement of Judgments § 68 cmt. o (1942))).

Nor was the value of the ownership interest "identical in all respects" to an issue presented in the trial court. A constructive trust is "imposed on particular assets, not on a value." *Estate of Cowling v. Estate of Cowling*, 847 N.E.2d 405, 412 (Ohio 2006). To illustrate, "if a party is inequitably deprived of 100 shares of stock that are valued at $10,000, a constructive trust should be imposed over 100 shares of stock, not $10,000." *Id.*; *see also* Dobbs, *supra*, § 4.4, at 625 ("[W]henever the plaintiff is entitled to a constructive trust, he is by definition entitled ***to a specific thing***." (emphasis added)). Because the constructive trust allows the plaintiff "to recover the asset ***in specie***" rather than "a money substitute," *id.* § 4.3(2), at 589, 595 (emphasis added), courts have imposed it in cases where the value of the "specific thing" was uncertain,

speculative, or otherwise not established. *See Evergreen W. Bus. Ctr., LLC v. Emmert*, 323 P.3d 250, 258 (Or. 2014) ("[I]n the constructive trust claim, plaintiff sought specific relief that did not require a determination of the value of the property at that point in time."); *Walker v. Res. Dev. Co.*, 791 A.2d 799, 811 (Del. Ch. 2000) (enforcing constructive trust even though plaintiff "made no effort to prove the fair value of his 18% interest" in the business); *Hanover Ins. Co. v. Sutton,* 705 N.E.2d 279, 295 (Mass. App. Ct. 1999) (trial court imposed constructive trust over unfairly diverted business opportunity even though court determined damages "to be 'uncertain' and not quantifiable"); *Butler v. Attwood*, 369 F.2d 811, 812 n.2 (6th Cir. 1966) (enforcing constructive trust even though "damages could not be adequately measured"); *Waller v. Blue Cross of Cal.*, 32 F.3d 1337, 1340 (9th Cir. 1994) (plaintiffs could pursue a constructive trust even though they lacked standing to seek damages); *Procom Energy, L.L.A. v. Roach*, 16 S.W.3d 377, 383-85 (Tex. App. 2000) (affirming constructive trust where jury found no damages).

Under the Court of Appeals' narrow value-centric view of the constructive trust, each of these cases was wrongly decided. This is not the law, and the Court of Appeals cites ***no*** authority for its decision. App. at 12, 16. This Court should grant review and reiterate the fundamental principle that "'constructive trust is based on property,'" not its value. *Harris Trust*, 530 U.S. at 251 (citation omitted). This will restore the broad powers of Washington courts to impose constructive trust in specie when (as here) the property can be traced to a breach of fiduciary duty.

### C. The Court of Appeals Erred by Invoking Collateral Estoppel to Allow Discovery Violators to Benefit from Their Own Wrongdoing

The Court of Appeals' erroneous emphasis on the constructive trust claim caused it to turn a blind eye to Green's and the Kotters' calculated withholding of evidence in the Arbitration. Without explaining how it knew the contents of the documents spoliated by Green, the Court of Appeals reasoned that those documents and the records withheld by the Kotters were not "key evidence" because "they did not relate to the value of Green's interest in Sage|Kotter or to damages." App. at 15. Although the value of Green's interest in Sage|Kotter is immaterial to Petitioners' claim for constructive trust, the documents withheld were relevant to other issues in the Arbitration, including the hasty, overnight reorganization of Sage|Kotter while Arbitration was pending, the successor status of Kotter International, and the Kotters' credibility.

In response to the Wormans' motion to compel, the Arbitrator ordered the Kotters to produce "[q]uarterly and annual financial documents ... reflecting or otherwise relating to facts pertaining to the valuation of Sage|Kotter and of equity and membership interest(s) therein[.]" CP 3288. The Kotters failed to comply. App. at 14-16. They ***withheld more than 13,000 documents totaling over 40,000 pages*** related to Sage|Kotter's business, CP 1821, including:

- Documents evidencing Sage|Kotter's financial performance in 2009 and 2010, including income statements, cash flow summaries, and projected financial statements. CP 2133-449;
- Sage|Kotter's contracts with Westinghouse, NetApp, Inc., and the U.S. Army. CP 1965-80, 2450-518. Those three contracts

comprised 75 percent of Sage|Kotter's annual revenue and became Kotter International's largest revenue source. CP 1332, 1338; and

- The "Member Services Agreement" through which Kotter licensed his intellectual property to Sage|Kotter. CP 1954-63. That document contradicted Kotter's testimony in Arbitration that he "flat[ly]" ... refus[ed] to issue a license or allow any other outside control over what he considered his intellectual property ...." App. at 32; *see also* CP 1530 ("I gave no written intellectual property contract to Sage|Kotter.").

The Court of Appeals explained its tolerance of the Kotters' calculated discovery violations by stating that the "Worman[s] could have ... moved to compel the production of other records but chose not to do so." App. at 16. This is plainly not the law. *Wash. State Physicians Ins. Exch. & Ass'n v. Fisons Corp.*, 122 Wn.2d 299, 353, 858 P.2d 1054 (1993) (rejecting the argument that withholding discoverable evidence is excused if the other party "fail[s] to move to compel production of those documents"). If these documents had been produced, the Wormans would have been able to challenge Kotters' credibility and demonstrate that Green and Kotter colluded in depriving the Arbitrator of all relevant evidence related to Sage|Kotter's business. And if the Arbitrator had documents evidencing Sage|Kotter's actual financial performance in 2009 and 2010, a "real" cash-flow method valuation of Sage|Kotter could have been possible. By withholding these documents, Respondents reduced the Arbitrator to speculation.

The Court of Appeals reasoned that the Arbitration was "procedurally fair" to the Wormans because they prevailed anyway. App. at 15-16. But collateral estoppel requires more than that. Collateral

estoppel "is not to be applied so rigidly as to defeat the ends of justice, or to work an injustice." *Henderson v. Bardahl Int'l Corp.*, 72 Wn.2d 109, 119, 431 P.2d 961 (1967). For that reason, collateral estoppel does not apply against a party that was deprived of an "unencumbered" opportunity to litigate his claim in the earlier action. *Rains v. State,* 100 Wn.2d 660, 666, 674 P.2d 165 (1983). When key evidence was omitted in the earlier action or where a party intends to offer evidence not previously offered, this element is not met and collateral estoppel does not apply. *See Frese v. Snohomish Cnty.*, 129 Wn. App. 659, 665, 120 P.3d 89 (2005) (collateral estoppel did not bar subsequent action "due to the lack of evidence" in prior action); *Babcock v. State*, 112 Wn.2d 83, 93, 768 P.2d 481 (1989) (collateral estoppel did not bar subsequent action because "key evidence was omitted" from prior action).

This Court should accept review to clarify that fairness is a central element of collateral estoppel. "Procedural fairness" can be invoked only by a party with clean hands. One who wrongfully withholds discoverable evidence in the prior action cannot leverage his discovery violation by invoking collateral estoppel in a subsequent case.

### D. The Court of Appeals Created a Roadmap for Avoiding Successor Liability

Washington law recognizes four exceptions to the general rule that a transferee of assets is not liable for the transferor's debts and obligations. *Martin v. Abbott Labs.*, 102 Wn.2d 581, 609, 689 P.2d 368 (1984). The Court of Appeals misapplied the exception known as "mere continuation," which prevents an entity from escaping liability by

"changing hats." It pronounced that Kotter International was not liable as a successor to Sage|Kotter because "the settlement and mutual release [between Green and the Kotters] liquidated and terminated Green's interest, whether identified in specie or in dollars." App. at 20. This ignored binding precedent and drew a roadmap for wrongdoers and their allies to contract around successor liability.

The "mere continuation" exception requires (1) a common, but not necessarily complete, identity of officers, directors, and stockholders; and (2) sufficient consideration provided to the selling entity in light of the assets sold. *Cambridge Townhomes, LLC v. Pac. Star Roofing, Inc.*, 166 Wn.2d 475, 482-83, 209 P.3d 863 (2009). On the record here, both elements are undisputed. The Kotters owned 62 percent of Sage|Kotter and own 100 percent of Kotter International. CP 768, 1145. Kotter International provides the same services, to the same clients, under the same contracts, under the same officers and executive team, in the same office space, using the same equipment, supplies, and professional insurance policy as Sage|Kotter. CP 413-14, 417-19; *see also Culinary Workers & Bartenders Union No. 596 Health & Welfare Trust v. Gateway Café, Inc.*, 91 Wn.2d 353, 367, 588 P.2d 1334 (1979) (ignoring formal dissolution of corporation and imposing successor liability where successor operated the same business, with the same employees, in the same location, and having received the assets of predecessor). And the Kotters and Kotter International paid Sage|Kotter nothing for its assets, including its long-term contracts, intellectual property and proprietary

processes, skilled employees, business model and structure, marketing plan, accounts receivable, goodwill, or any intangible asset. CP 1363-66, 1758, 1770, 1788; *see also Eagle Pac. Ins. Co. v. Christensen Motor Yacht Corp.*, 135 Wn.2d 894, 903, 959 P.2d 1052 (1998) (imposing successor liability and rejecting the argument that the predecessor's contracts "had no market value since any potential profit from completing the contracts was too speculative").

The Court of Appeals put collusive form (the Settlement Agreement) over undisputed substance allowing Green and the Kotters to contract around successor liability. App. at 20. That is the very situation that successor liability was designed to prevent. *See Eagle Pac.*, 135 Wn.2d at 901 ("Liability may be imposed regardless of the exact form of transfer of assets between the corporations."). This Court should accept review to clarify that parties may not evade their obligations and contract around successor liability.

## VI. CONCLUSION

For the reasons stated, this Court should accept review and reverse the Court of Appeals' decision.

DATED: September 23, 2015.

STOEL RIVES LLP

David R. Goodnight, WSBA #20286
John E. Glowney, WSBA #12652
Rita V. Latsinova, WSBA #24447
Aric H. Jarrett, WSBA #39556

Attorneys for Petitioners

## CERTIFICATE OF SERVICE

I certify that on September 23, 2015, I caused a copy of the foregoing **Appellants' Petition for Review** to be served by hand delivery upon following counsel of record:

Robert M. Sulkin
Malaika Eaton
Timothy Fitzgerald
McNAUL EBEL NAWROT & HELGREN
600 University St., Ste. 2700
Seattle, WA 98101
rsulkin@mcnaul.com
meaton@mcnaul.com
tfitzgerald@mcnaul.com

*Counsel for Respondents*

DATED: September 23, 2015, at Seattle, Washington.

Shelley Sasse, Legal Secretary
STOEL RIVES LLP
smsasse@stoel.com

**APPENDIX**
**TABLE OF CONTENTS**

**IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON**

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| THE SAGE GROUP I, LLC, a Washington limited liability company; M3, INC., a Washington corporation; RONALD WORMAN and SALLY WORMAN, individually and the marital community composed thereof; ERIK VAN ALSTINE, individually and his marital community,<br><br>Appellants,<br><br>v.<br><br>JOHN KOTTER and NANCY DEARMAN, individually and the marital community composed thereof; KOTTER ASSOCIATES, INC., a Massachusetts corporation; KOTTER INTERNATIONAL, INC., a Massachusetts corporation; SAGE\|KOTTER, LLC, an inactive Delaware limited liability company,<br><br>Respondents. | No. 71405-8-I<br><br>DIVISION ONE<br><br>UNPUBLISHED OPINION<br><br>FILED: August 24, 2015 |

LEACH, J. — The Sage Group I LLC, M3 Inc., Ronald and Sally Worman, and Erik Van Alstine (collectively Sage Group) appeal a trial court's summary judgment ruling that collateral estoppel bars Sage Group's constructive trust claims against John Kotter and Kotter's wife, Nancy Dearman (collectively the Kotters), and the Kotters' business entities. Sage Group also challenges the trial

court's denial of its motions for summary judgment on the basis of constructive trust and successor liability.

Because Sage Group had a full and fair opportunity at arbitration to litigate the central issue in this case—the value of a former business partner's ownership interest—we affirm the trial court's conclusion that collateral estoppel bars Sage Group's claims for constructive trust. And because the arbitrator and trial court both correctly determined that no property existed over which they could justly impose a constructive trust, we affirm the trial court's denial of Sage Group's motion for summary judgment.

FACTS

In 2002, Ronald Worman and Dana Green formed the Sage Group, which provided advice, consulting, and services to business entities, using its "Path to Value™" methodology. As managing members of the Sage Group, Worman and Green shared equally the income generated by consulting agreements, plus any stock or other ownership interests they obtained in the companies they assisted. Erik Van Alstine, who ran M3 Inc., was not a member of the Sage Group but at various times worked as a consultant to the company.

In spring 2007, Van Alstine e-mailed Dr. John Kotter, a Harvard Business School professor and successful author of books on business leadership and organizational change. Kotter and his wife, Nancy Dearman, established and

owned Kotter Associates Inc., a multimillion dollar business they operated. Van Alstine, Worman, and Green believed that Kotter represented a valuable business opportunity, and Kotter wished to promote his ideas in a way that reached many more people.

In fall 2007, Van Alstine introduced Kotter to the Sage Group, and in February 2008, Kotter and the Sage Group executed a written consulting agreement. This agreement, signed by Green as "Managing Principal," provided for $20,000 per month payments to the Sage Group from February through October 2008 in exchange for using its Path to Value™ methodology to implement Kotter's business plan. The agreement specified that it was "intended to provide for the provision of consulting services on an independent contractor basis, and is expressly not intended to create a joint venture, partnership, agency, employment or other relationship." It made no reference to Worman or Van Alstine.

Because Green, Worman, and Van Alstine agreed that Green would take the lead in building a relationship with the Kotters, Green continued to travel to Boston and work directly with them. In June 2008, John Kotter proposed creating a new relationship: "No consultant and client. All new revenue from joint activities is split by some formula." Green agreed, and he and Kotter pursued plans to create a new business. Initially, Worman participated in some

discussions. In communications about business and personal goals and priorities, Kotter emphasized the importance of maintaining a reputation "as pure as snow white" and that he "won't work with anybody of questionable ethics." Green, Van Alstine, and Worman agreed that they would share equity interests in the new business equally but did not tell the Kotters about this arrangement.[1]

The Sage Group, Worman, and Van Alstine worked with Green to help develop Sage|Kotter, established as a Delaware limited liability company (LLC) in August 2008. Green continued to communicate with Worman about ongoing negotiations related to ownership interests but disclosed progressively less information. By the last months of 2008, Green pursued only his interests in Sage|Kotter and no longer promoted Worman's interests as his co-member or the interests of Sage Group as a whole.

In October 2008, Kotter proposed that Dearman own 51 percent of Sage|Kotter and Green or "[Green] and friends" own 49 percent. In December, however, Worman received from Green a proposed Sage|Kotter operating agreement that allocated to the Kotters and Green 96 percent of the company and all voting and management rights. It provided Worman a 4 percent nonvoting interest. The agreement made no provision for Van Alstine. In

[1] They also did not tell them that in 2000, state authorities found Van Alstine and a company on whose board Worman was a member liable for violations of securities laws.

January 2009, over Worman and Van Alstine's objections, Green and the Kotters executed the final version of the Sage|Kotter LLC operating agreement. This agreement allocated to Green and the Kotters 38 percent and 62 percent ownership interests, respectively. It also made no provision for Worman or Van Alstine.

The Sage|Kotter operating agreement provided that the Kotters could unilaterally dissolve the LLC at any time during a five-year "initial period." The Kotters' attorney clarified in an e-mail that "[Kotter] expressly wants to retain and does retain all his 'inventions' under the IP [intellectual property] Licensing Agreement, while, at the same time, he grants the LLC an exclusive license to all such inventions." And a member services agreement executed by Green and Kotter memorialized Kotter's absolute control over his intellectual property as "head of research, with the title Chief Innovation Officer":

> [Kotter] is expressly granted the authority to claim the copyright or the sharing of the copyright for all ideas, products or services based substantially on his work on behalf of himself, on behalf of Sage|Kotter or on behalf [of] some combination of individuals and Sage|Kotter, as he deems fair and appropriate in his sole and absolute discretion.[2]

In 2009, Sage|Kotter generated revenues almost triple what Kotter Associates had generated the previous year, increasing from $2.8 million to over $7 million. The majority of revenue came from consulting fees, such as a

[2] This agreement is undated but includes a footer dated January 5, 2009.

contract between Sage|Kotter and Westinghouse Electric Company for $1 million, which Green signed as "President and CEO [chief executive officer]" of Sage|Kotter.

Claiming that Green usurped a business opportunity and committed breaches of contract, fiduciary duties, and good faith by pursuing his personal interest in Sage|Kotter without their consent, Worman and Van Alstine commenced separate legal actions against Green. In April 2009, Worman filed an arbitration demand and complaint against Green under the terms of the Sage Group's LLC agreement. Van Alstine, not a member of Sage Group LLC, later filed a separate lawsuit in King County Superior Court. The same counsel represented Worman and Van Alstine in their respective actions, and they coordinated discovery. Van Alstine and Worman sought damages, disgorgement, and imposition of a constructive trust "for all property, profits, and/or benefits derived by Green related to Sage|Kotter and/or Green's interest therein."

The Kotters learned in late spring 2009 about the arbitration demand. They had some discussions with Green and his attorney around the time of a failed mediation in October 2009. Sage|Kotter paid some of Green's legal fees. The Kotters learned of Van Alstine's lawsuit in late fall 2009.

In a December 7, 2009, letter, the Kotters' attorney told counsel for Green and counsel for Worman and Van Alstine that the Kotters "will not allow the internal dispute between your clients to disrupt the business operations of Sage|Kotter or divert the attention of our clients or its employees from carrying out the goals that led to its formation":

> Accordingly, this is to advise your respective clients that unless the present dispute between your clients is resolved in a manner satisfactory to our clients on or before December 21, 2009, our clients intend to exercise their rights under the Sage|Kotter Operating Agreement, dissolve Sage|Kotter and immediately commence to wind up its affairs.

Green and Worman did not resolve their dispute. Van Alstine's lawsuit against Green continued.

On January 6, 2010, Green and the Kotters signed a "Settlement Agreement and Mutual Releases." It had the stated purposes of effecting the orderly liquidation of Sage|Kotter and settling all actual and potential claims between the Kotters and Green. The agreement terminated Green's employment as CEO of Sage|Kotter. Green received $150,000 as a "settlement payment" and an additional $160,889 in liquidated distributions in proportion to his 38 percent interest. The Kotters also received liquidated distributions, and

Kotter Associates Inc. received the remaining assets and obligations.[3] The agreement included a broad mutual release of Sage|Kotter-related claims.

In July 2010, arbitrator Judge Robert Alsdorf (retired) heard Worman's arbitration action. Worman requested an award of almost $5 million, his calculation of half the value of Green's 38 percent equity interest in Sage|Kotter.

The arbitrator found that because "[t]he evidence overwhelmingly supports the conclusion" that Green breached contract and/or fiduciary duties by his self-dealing, Worman was entitled to damages and other relief. This conclusion was "bolstered by a strong showing of spoliation of hard copy and electronic records that had been in Mr. Green's possession, custody, and control." Judge Alsdorf characterized Green's testimony as "unclear" and lacking credibility and the Kotters' testimony as "credible."

However, the arbitrator rejected Worman's proposed valuation of Green's interest, noting that "[t]he projections on which claimants and their expert purported to establish a value were not factually sound and were at best speculative." Judge Alsdorf concluded that because of the Kotters' contractual authority to unilaterally dissolve Sage|Kotter and Kotter's absolute control over his intellectual property, Green's interest in the company was essentially

[3] The Kotters later changed the name of the company to Kotter International Inc.

"terminable at will," and a reasonable buyer would have been "extremely unlikely to pay more than a nominal premium" for it.

The arbitrator concluded that "the only reasonable measure of damages is not a business valuation *per se* but a requirement that [Green] disgorge 50% of the value he in fact received in 2009 for the business opportunity that he had wrongfully taken at the end of 2008." Judge Alsdorf awarded Worman $522,883.00 in damages: the sum of $413,562.50 (half of the 2009 benefits and compensation Sage|Kotter paid Green), $34,320.50 (half of Green's compensation for the last two months of 2008), and $75,000.00 (half of Green's "settlement payment"). Judge Alsdorf also granted declaratory relief, ordering a "required sales event" under the terms of the Sage Group's LLC agreement and terminating Green's status and rights of control or participation as a manager in the Sage Group. In September 2010, Judge Alsdorf awarded Worman $480,532.66 in reasonable attorney fees and costs.

Worman and Van Alstine consolidated discovery in the arbitration with discovery in Van Alstine's state court action. Van Alstine's action settled before trial, in May 2011.

In August 2011, Worman and Van Alstine filed an amended complaint against the Kotters and their business entities, alleging conspiracy, fraudulent transfer, aiding and abetting breach of fiduciary duty, and unjust enrichment.

They requested, among other things, imposition of a constructive trust over Green's 38 percent equity or membership interest in the Kotter business entities.

Over the next two years of litigation, Worman and Van Alstine filed a motion to dismiss Kotter's counterclaims and four motions for summary judgment. The trial court denied all the motions.

On November 27, 2013, the trial court granted the Kotters' motion for summary judgment, ruling that Worman and Van Alstine were collaterally estopped from pursuing a constructive trust remedy over Green's 38 percent interest in Sage|Kotter. On January 21, 2014, the trial court entered a final judgment.

Sage Group, Worman, and Van Alstine appeal.

STANDARD OF REVIEW

This court reviews a trial court's order on summary judgment de novo, performing the same inquiry as the trial court and drawing all inferences in favor of the nonmoving party.[4] CR 56(c) requires summary judgment when the pleadings, affidavits, depositions, and admissions on file demonstrate that there are no genuine issues of material fact and that the moving party is entitled to judgment as a matter of law.

[4] Lybbert v. Grant County, 141 Wn.2d 29, 34, 1 P.3d 1124 (2000).

ANALYSIS

Collateral Estoppel

Sage Group asserts that collateral estoppel does not bar its claims for constructive trust. Collateral estoppel, or issue preclusion, prohibits a party from relitigating issues in a subsequent proceeding, even when it asserts different claims or causes of action.[5] "The purpose of the doctrine is to promote the policy of ending disputes."[6] Collateral estoppel precludes only those issues that have actually been litigated and necessarily determined in the earlier proceeding.[7] And the party against whom collateral estoppel is asserted must have had a "full and fair opportunity to litigate the issue in the earlier proceeding."[8] A party asserting collateral estoppel must show that (1) the issue in both actions is identical; (2) the earlier proceeding ended in a judgment on the merits; (3) the party against whom collateral estoppel is asserted was a party to, or in privity with a party to, the earlier proceeding; and (4) applying collateral estoppel does not work an injustice on the party precluded from litigating the issue.[9]

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[5] Christensen v. Grant County Hosp. Dist. No. 1, 152 Wn.2d 299, 306, 96 P.3d 957 (2004) (quoting Rains v. State, 100 Wn.2d 660, 665, 674 P.2d 165 (1983)).

[6] Nielson v. Spanaway Gen. Med. Clinic, Inc., 135 Wn.2d 255, 262, 956 P.2d 312 (1998).

[7] Christensen, 152 Wn.2d at 307 (citing Shoemaker v. City of Bremerton, 109 Wn.2d 504, 507, 745 P.2d 858 (1987)).

[8] Christensen, 152 Wn.2d at 307 (citing Nielson, 135 Wn.2d at 264-65).

[9] World Wide Video of Wash., Inc. v. City of Spokane, 125 Wn. App. 289, 305, 103 P.3d 1265 (2005) (quoting Christensen, 152 Wn.2d at 307).

First, Sage Group argues that the issues in both actions are not identical: "The issue of valuation was neither identical to the issues in the arbitration, nor was it necessarily determined in the arbitration." Sage Group contends that because the value of Green's interest was not an element of the disgorgement remedy, findings about that value were not "'necessarily determined' and are, at most, evidentiary facts to which collateral estoppel does not apply." Sage Group also maintains that because a court may impose a constructive trust in specie, "the value of Green's interest, even if 'speculative,' is not material to enforcement."

Sage Group correctly notes that collateral estoppel applies to "ultimate facts," or facts "directly at issue in the first controversy upon which the claim rests" but does not apply to "evidentiary facts, facts which may be in controversy in the first action and are proven but which are merely collateral to the claim asserted."[10] But as the trial court stated in its order, "While the parties in this case give different labels to the remedies sought, in the Alsdorf Arbitration and this case, one of the central damages issue[s] in each has been to determine the value of Green's interest in Sage|Kotter." Thus, the "ultimate facts" in both the arbitration and Sage Group's lawsuit against the Kotters involved the valuation of Green's 38 percent interest in Sage|Kotter. We agree with the trial court that for

[10] Beagles v. Seattle-First Nat'l Bank, 25 Wn. App. 925, 930-31, 610 P.2d 962 (1980).

purposes of collateral estoppel, "[t]he remedy issue to be decided here is identical to the issue that Judge Alsdorf decided."[11]

Sage Group also contends that because Van Alstine could not have been joined as a party to the arbitration, Kotter cannot establish privity. We disagree.

One must show more than representation by the same counsel to establish privity for purposes of issue preclusion.[12] But as the trial court noted, counsel for Worman and Van Alstine consolidated discovery in both cases, and "[d]iscovery from one case was used in the other and pleadings in each referenced the other proceeding. In fact, Judge Alsdorf referenced the Superior Court discovery proceedings in his pretrial Arbitration Orders." Van Alstine, pursuing claims in a parallel proceeding relating to the same issue, "exercised control" via the same attorneys, same discovery, and same legal theories, and was thus "virtually represented" in the arbitration, the resolution of which would directly affect his own superior court claims.[13] Thus, due to Van Alstine's

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[11] As for the second element of collateral estoppel claim, the parties do not dispute that the arbitration represented a final judgment on the merits. See also Neff v. Allstate Ins. Co., 70 Wn. App. 796, 799-800, 855 P.2d 1223 (1993) (for purposes of collateral estoppel, arbitration may be "prior adjudication" ending in a final judgment).

[12] Collins v. E.T. DuPont de Nemours & Co., 34 F.3d 172, 178 (3d Cir. 1994).

[13] Collins, 34 F.3d at 178; see also Carson Inv. Co. v. Anaconda Copper Mining Co., 26 F.2d 651, 657 (9th Cir. 1928) (privity established where counsel for both parties conferred and participated together in preparation of trial on issues, parties had right to exercise joint control over litigation and cooperated in both proceedings); Everett v. Abbey, 108 Wn. App. 521, 532-33, 31 P.3d 721

preexisting legal relationship to Worman, the trial court fairly concluded that "'they represent the same legal right.'"[14] We agree that the parties were in privity for purposes of collateral estoppel.

Finally, Sage Group argues that barring its claims on the basis of collateral estoppel works an injustice because Sage Group did not have an "'unencumbered' opportunity to litigate [its] claim in the earlier action." Sage Group bases this argument on the arbitrator's finding of a "strong showing" of Green's spoliation of hard copy and electronic evidence and on allegations that the Kotters "withheld discoverable evidence from the Arbitration," producing it for the first time in this action.

To decide if application of collateral estoppel will work an injustice, "'Washington courts focus on whether the parties to the earlier proceeding had a full and fair hearing on the issue.'"[15] If a party might receive procedural opportunities in a later action that were unavailable in the first and could

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(2001) (collateral estoppel did not apply where parties were not represented by counsel and did not control any part of proceedings); Paradise Orchards Gen. P'ship v. Fearing, 122 Wn. App. 507, 515-16, 94 P.3d 372 (2004) (no privity where party had no opportunity to argue theory of case in first proceeding).

[14] Collins, 34 F.3d at 177 (quoting E.I.B. v. J.R.B., 259 N.J. Super. 99, 102, 611 A.2d 662 (1992) (privity in claim preclusion context)).

[15] State Farm Fire & Cas. Co. v. Ford Motor Co., 186 Wn. App. 715, 725, 346 P.3d 771 (2015) (internal quotation marks omitted) (quoting Hadley v. Maxwell, 144 Wn.2d 306, 311, 27 P.3d 600 (2001)). Appellants cite State Farm in a statement of additional authorities.

reasonably cause a different result, application of collateral estoppel would be unjust.[16]

Applying collateral estoppel does not work an injustice here. Contrary to Sage Group's claims, the spoliated records were not "key evidence." Their omission did not prevent procedural fairness. These records pertained to Green's "substantially changed focus and motivation" leading to his self-dealing and breaches of contract and fiduciary duty, which were not in dispute. They did not relate to the value of Green's interest in Sage|Kotter or to damages. Moreover, as the trial court noted, the matter of Green's spoliation "was known and litigated during the Arbitration, and the documents and their destruction was a major reason why Judge Alsdorf found Green incredible on issues of liability."

Sage Group also argues that collateral estoppel works an injustice because the Kotters wrongly withheld discoverable evidence: the written "Member Services Agreement" through which Kotter licensed his intellectual property to Sage|Kotter. This written agreement contradicts Kotter's testimony in the arbitration that he orally licensed the intellectual property.

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[16] Parklane Hosiery Co. v. Shore, 439 U.S. 322, 332, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979); State Farm, 186 Wn. App. at 725; see also Frese v. Snohomish County, 129 Wn. App. 659, 664-66, 120 P.3d 89 (2005) (collateral estoppel did not bar plaintiffs' action where new evidence presented in second action would likely have changed result in first).

Sage Group does not show any lack of fairness. First, Sage Group does not show it was deprived of any procedural opportunities. As the trial court noted, both Worman and Van Alstine conducted and shared discovery. Judge Alsdorf granted in part Worman's motion to compel discovery of certain Sage|Kotter financial documents. Where the arbitrator reserved ruling, Worman could have shown good cause or moved to compel the production of other records but chose not to do so. Second, the member services agreement supports the conclusion Judge Alsdorf reached without it. Consistent with the Sage|Kotter operating agreement, the member services agreement provided for "voluntary termination" by Kotter. Because the exceptionally "one-sided business agreement" already allowed Kotter to unilaterally dissolve the LLC and revoke any license to his intellectual property, the trial court concluded that there was no reasonable likelihood that production of the written member services agreement before arbitration would have caused a different result: "The Arbitration was procedurally fair and the documents later disclosed would not reasonably have changed the outcome."

Because the essential factual basis of the constructive trust claim was resolved against Worman in the arbitration, Van Alstine was in privity with Worman, and the arbitration was procedurally fair, the trial court did not err in concluding that collateral estoppel barred Sage Group's constructive trust claims.

Constructive Trust and Successor Liability

Nor did the trial court err by denying Sage Group's motion for summary judgment for constructive trust and successor liability. "A constructive trust is an equitable remedy which arises when the person holding title to property has an equitable duty to convey it to another on the grounds that they would be unjustly enriched if permitted to retain it."[17] Where a fiduciary transfers property subject to a constructive trust, the transferee holds the property subject to a constructive trust unless the transferee is a bona fide purchaser who paid valuable consideration and took without notice of the transferor's violation of duty.[18] A party requesting the imposition of a constructive trust must show the trust arose from the relationship of the parties involved and that the property justly belongs to that party.[19]

Sage Group argues that because the Kotters dissolved and transferred the assets of Sage|Kotter, the arbitrator was unable to impose a constructive trust and thus "unable to award a complete remedy for Green's breach." And because the Kotters and Kotter International acquired Green's 38 percent ownership interest "without consideration and with notice of the Wormans' pending claims," Sage Group contends, "[they] took it subject to a constructive

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[17] City of Lakewood v. Pierce County, 144 Wn.2d 118, 126, 30 P.3d 446 (2001).

[18] Hesthagen v. Harby, 78 Wn.2d 934, 945-46, 481 P.2d 438 (1971).

[19] City of Lakewood, 144 Wn.2d at 129.

trust as a matter of law," from which Sage Group is entitled to "a complete remedy for Green's fiduciary breaches."

Sage Group does not show any entitlement to a constructive trust. First, Sage Group does not establish that the Kotters owed them any duty. It was Green who owed and breached fiduciary duties to Worman and Van Alstine, and their interest in Sage|Kotter was limited to his interest. Second, because of the Kotters' extraordinary authority under the LLC agreement, Green's 38 percent ownership interest had little or no value, and the Kotters did nothing improper by exercising their authority to dissolve Sage|Kotter. Therefore, the Kotters were not unjustly enriched by the termination of Sage|Kotter so as to justify the imposition of a constructive trust. Finally, Sage Group had no relationship with the Kotters and cannot show that any Kotter property rightfully belongs to them.

Sage Group cites no authority supporting its claim that a court properly imposes a constructive trust over property that has no value. As the arbitrator noted, the Kotters did not "transfer" any continuing business interest of Green's. Rather, they terminated and liquidated his interest in consideration of $150,000 they paid "in settlement of any and all possible interests, claims, differences or disputes between the Greens and the Kotter Parties, of any kind or nature," plus a liquidated distribution of Sage|Kotter assets proportionate to Green's interest. Both the arbitrator and the trial court found that because of the remarkable

degree of power Kotter maintained over the company and the one-sided nature of the operating agreement, Green's interest remained "nominal" in value and "terminable at will," and that the Kotters did in fact terminate it. Judge Alsdorf concluded that under the facts of this case, no property rightfully belonging to Sage Group existed over which to impose a constructive trust:

> Had Sage|Kotter continued to exist, or had it been established that Sage|Kotter was to be recreated and Mr. Green restored to ownership, a continuing or constructive trust could have been imposed on any present and/or future interest as requested. As it was, however, the final preponderance of the evidence was not only that the Kotters themselves had divested Mr. Green of his own interest in Sage|Kotter but also that the parties' jointly hoped-for valuable business opportunity had always been more illusory than real.

Worman and Van Alstine were not co-members of Sage|Kotter to whom Kotter owed a fiduciary duty in terminating the LLC. Nor were they judgment creditors whose claims Kotter deliberately avoided in conveying the assets of Sage|Kotter to Kotter Associates Inc. Green's compensation and benefits from the business opportunity, settlement payment, and liquidated distributions were the only property to which Worman and Van Alstine had a claim, and they received the value of that property at arbitration and in settlement. No property of Green's remained by which the Kotters could be unjustly enriched. Therefore, the Sage Group identified no Kotter property over which a court could reasonably impose a constructive trust. Green, the only possible claimant to the Sage|Kotter

assets under the LLC agreement, accepted a settlement that the Sage Group did not challenge.[20]

For the same reason, Sage Group's successor liability claim also fails. Generally, a corporation that purchases the assets of another corporation does not assume the debts and liabilities of the selling corporation.[21] However, to protect the rights of creditors and minority shareholders, Washington law recognizes four "narrow exceptions" to the general rule: (1) the purchaser agrees to assume liability, (2) the purchase is a de facto merger or consolidation, (3) the purchaser is a "mere continuation" of the seller, or (4) the transfer of assets is for the fraudulent purpose of escaping liability.[22]

Sage Group argues that the third exception applies here, alleging that Kotter International is a "mere continuation" of Sage|Kotter and should not escape liability for Green's 38 percent interest. But the settlement and mutual release liquidated and terminated Green's interest, whether identified in specie or in dollars. Sage Group could and did rightfully assert claims against the property Green received at dissolution, but Kotter International assumed no liability based on those claims. The trial court did not err by denying Sage Group's motions for summary judgment on constructive trust and successor liability.

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[20] The Kotters argue, "If anything, Green is the one who was unjustly enriched," and Worman and Van Alstine benefited from his unjust enrichment.

[21] Martin v. Abbott Labs., 102 Wn.2d 581, 609, 689 P.2d 368 (1984).

[22] Martin, 102 Wn.2d at 609.

## CONCLUSION

Because collateral estoppel bars Sage Group's constructive trust claims and the trial court correctly denied Sage Group's motions for summary judgment and successor liability, we affirm.

Leach, J.

WE CONCUR:

Trickey, J

Dwyer, J.

ALSDORF
DISPUTE RESOLUTION

**PRIVATE ARBITRATION PROCEEDINGS**
**BEFORE ALSDORF DISPUTE RESOLUTION**
**SEATTLE, WASHINGTON**

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| RONALD WORMAN and SALLY WORMAN, individually and the marital community comprised thereof,<br><br>Claimants,<br><br>v.<br><br>DANA GREEN, individually and his marital community,<br><br>Respondent. | **Arbitration No. 1519**<br><br>**FINAL REASONED AWARD ON SUBSTANTIVE ISSUES** |

Pursuant to Section 13.12 of the First Amended and Restated Operating Agreement of the Sage Group I, LLC, this matter came on for Hearing on the Merits before the undersigned Arbitrator, commencing on July 12, 2010 and concluding on July 15, 2010. The undersigned has heard, considered and weighed the live testimony presented by the parties, their deposition designations and exhibits, and the legal arguments and presentations of their respective counsel,


**ALSDORF DISPUTE RESOLUTION**
901 12th Avenue / P.O. Box 222000
Seattle, WA 98122-1090 Tel: 206-228-8575

and has made determinations of competence and credibility, and based thereon now makes and enters the following Final Reasoned Award as to all substantive claims, counterclaims and defenses at issue herein:

**Nature of Claims, Counterclaims and Defenses**

Claimants and respondent entered into their First Amended and Restated Operating Agreement ("the parties' LLC Agreement" or "the Agreement") of the Sage Group I, LLC ("the Sage Group") in 2002. Section 12 of the Agreement reads as follows:

> Absent the prior written consent of all of the Managers, no Member or Manager shall be entitled to enter into a transaction that may be considered to be competitive with, or a business opportunity that may be beneficial to, the Company. All Members and Managers shall account to the Company and hold, as trustee for it, any property, profit, or benefit derived by the Member or Manager, without the consent of all the Managers, in the formation, conduct and winding up of the Company business or from a use or appropriation by the Member or Manager of any assets of the Company, including information developed exclusively for the Company and opportunities expressly offered to the Company.

*Ex. 2*, at RW 000029.

For at least five years, the Sage Group provided advice, consultation and services to various business entities relating to its "Path to Value" ("P2V") concept. Then, starting in late 2007, the parties considered broadening the scope of their business as and after they entered into a consulting agreement with Prof. John Kotter of the Harvard Business School. In connection with that arrangement, claimants and respondent began to explore various options as to the future structure of their business, the range of which they both agreed in sworn testimony constituted a Sage Group business opportunity at least through December 31, 2008.

The two parties had in the years preceding the Kotter contract agreed that as managing Members of the Sage Group they not only shared equally in income generated from consulting

agreements but also shared equally in any stock or other ownership interests obtained in the companies with whom they consulted. Early in 2009, respondent Dana Green officially took the position of CEO of, and secured a 38% ownership interest in, a new entity named Sage|Kotter LLC ("Sage|Kotter"). Neither the original Sage Group nor the Wormans received any interest in Sage|Kotter or was given a recognized role in its new business plan. It is not reasonably disputed that Dana Green took this opportunity without first securing the written consent of claimant Ron Worman.

The central question in this arbitration is whether respondent had and breached contract and/or fiduciary duties to the claimants when effectuating his personal arrangement with Sage|Kotter. The evidence overwhelmingly supports the conclusion that, when so doing, respondent had and breached contract and fiduciary duties. Claimants are therefore entitled to an award of damages and other relief.

**Duty and Breach**

Over the years, the parties had designated one or the other of them to take the lead in dealing with any given client company, and had then shared in the proceeds of that consulting relationship, whether in the form of income or ownership or both. The parties agreed from the start of the Kotter contract that respondent Dana Green would take the lead in dealing with Prof. Kotter in Boston, and that claimant Ron Worman would remain in Seattle and take the principal responsibility of dealing with the other Sage Group clients while the Kotter opportunity was explored.

Mr. Green did not take the lead in this new consultancy with the specific intent to take the resultant business opportunity for himself or otherwise to defraud or squeeze out Mr. Worman or

the Sage Group. Indeed, he initially seemed to expect that, as had been true for all Sage Group business opportunities to that date, he and Mr. Worman would share 50/50 in whatever value was generated by and from the Kotter relationship and business.

During 2008, many ideas were explored with Prof. Kotter about possible future Kotter-related business entities and plans connected with, under the leadership of, or in coalition with the Sage Group. At some point in the fall of 2008, however, it became apparent that Prof. Kotter and his wife Nancy Dearman might be prepared to designate Dana Green as the CEO and substantial owner of a new enterprise, one which ultimately took the name Sage|Kotter LLC. With the dawning of that realization, Dana Green began to change and to treat the more and more detailed business planning efforts as his personal opportunity rather than a Sage Group opportunity. He began to disclose progressively less information to Ron Worman and ultimately, no later than November 3, 2008, finalized his decision that his personal interests would be best served if he were personally to become part of Sage|Kotter and leave the Sage Group.

The evidence overwhelmingly supports this finding of Mr. Green's substantially changed focus and motivation. The evidence that is both in the record and not credibly rebutted is that Dana Green had made his final decision as to what was personally best for him at least two months before December 31, 2008, that Prof. Kotter was then prepared to accept the outlines of a business plan that Dana Green himself had suggested, that key draft language of the final Sage|Kotter LLC agreements was intentionally held back or delayed from transmittal to Ron Worman, and that Dana Green was untruthful when testifying about the declining nature and extent of his contemporaneous disclosures to and discussions with Ron Worman. The only

reasonable finding and conclusion on the record of this case is that in the last months of 2008 Dana Green was in fact putting his own interests first and was no longer doing anything even to try to promote the interests of Ron Worman as a co-Member or the interests of the Sage Group as a whole.

This conclusion is bolstered by a strong showing of spoliation of hard copy and electronic records that had been in Mr. Green's possession, custody and control. Dana Green's live testimony about regularly taking and retaining handwritten notes was persistently unclear. His live testimony about how he handled and then electronically filed emails was inconsistent and vague on one Hearing day and then more detailed on another. His document and record production was also strangely lacking; it is simply not believable that a person of Mr. Green's evident ability could honestly testify "I don't recall" when asked if he had even looked for the now absent notebooks and records. His earlier deposition testimony was likewise replete with claims that he did not know or could not recall various matters, claims which were, contradictorily, followed much later by specific recollections on the same given point, albeit without credible explanation of what materials could have refreshed his memory.

Mr. Green's lack of credibility is in distinct contrast to that of Prof. Kotter and his wife, Nancy Dearman. Their testimony was credible. Indeed, that is the one significant aspect of the evidence on which both claimants and respondent agreed at the time of the Hearing. Such an undisputed fact naturally affects the credibility and weight of other testimony, and the balance of the evidence taken as a whole. For example, it is undisputed that Prof. Kotter jealously guarded his reputation and his ability personally to control, to deliver on, and to receive compensation for, that which he considered to be his intellectual property. It therefore could be plausible to

posit that Dr. Kotter was unalterably determined, even had he been faced with vigorous and articulate persuasive efforts of a person in Dana Green's position, simply to refuse to share his business interests with another existing business entity or to give away any interest to a person who was not exclusively dedicated to Kotter himself. However, had that scenario been what had actually transpired in this case, there would have been no reason for Dana Green to have caused or allowed his records to vanish without believable explanation. It is more likely than not that, had that been the scenario, he could have and would have been motivated to present the detailed handwritten notes he regularly took and maintained in the ordinary course of business, and the emails he had sent and received and filed, and to describe the extent of his efforts to persuade Dr. Kotter and the nature and firmness of Prof. Kotter's rejection, all to support his current assertion that there was no and never had been a business opportunity that could have been exercised by Ron Worman or the Sage Group. And, equally important, had his records then innocently disappeared, it is far more likely than not that he would have remembered how carefully he had searched to find them.

Instead, Dana Green simply argued at the Hearing, largely without meaningful documentary support, that he had fought hard to make Ron Worman a partner in the new enterprise, that he had started by arguing for a significant ownership percentage for Ron Worman, and that the Kotters rejected all entreaties and themselves finally proposed a 4% ownership figure for Ron Worman. Had the Kotters themselves offered a 4% ownership interest for Ron Worman, there would have been no reason for them to have testified otherwise, but they denied doing so. If Dana Green had in truth argued successively for a 25% interest for Ron Worman, and then a 10% interest, the Kotters could easily have been heard to explain that they

did not want Ron Worman but simply offered 4% out of exasperation with Dana Green's repeated forays on the topic. Instead, the Arbitrator was presented with the simple, unchallenged and very direct testimony of Prof. Kotter that he "didn't have to do anything" about percentage shares for Ron Worman because "All of a sudden a document shows up and it's zero. That takes care of that." *Kotter Dep.*, at 114. More tellingly, Prof. Kotter also testified in deposition that Dana Green did not attempt a strong argument for Ron Worman having an ownership interest. *Id.*, at 116.

Nancy Dearman testified similarly in her deposition when she stated not only that she was neutral on the proposition of Dana Green sharing his interest with Ron Worman, but also that Dana Green had not described what Ron Worman could do to advance Sage|Kotter. She further stated that she thought Dana Green had a "group" in Seattle but did not really know them, and that she did not know why Dana Green had suggested an ownership interest for Ron Worman. *Dearman Dep.*, at 15-16, 35-36, 88-90.

It is certainly true that Prof. Kotter and his wife were from the start not eager to share ownership or involvement with others, but the substantial preponderance of the evidence is also that Dana Green made no meaningful attempt to address or overcome that protective stance and instead promoted his own interests. Had he in fact been seeking to promote Ron Worman and/or the Sage Group and not simply himself, that evidence would, more likely than not, have existed, and there would have been no reason for him to cause or allow spoliation of evidence.

As the lead on the Kotter interaction, and as a Managing Member, Mr. Green occupied a high fiduciary position that, once claimants had presented strong evidence of his self-dealing such as that described above, shifted to him the burden of dispelling all doubts concerning the

discharge of his duties. *See, generally*, Bovy v. Graham, Cohen & Wampold, 17 Wn. App. 567, 571 n. 3 (1977). Given his lack of credibility, and despite the fact that he was represented by extremely skilled and professional counsel, Mr. Green has failed to meet his burden. There is no significant credible countervailing evidence that would alter a factual finding that: (a) Dana Green failed meaningfully to pursue or promote the interests of co-Member Ron Worman or those of the Sage Group as a whole; (b) Dana Green did not fully or timely disclose to Ron Worman the nature of the Sage|Kotter negotiations in at least the last two months of 2008; (c) Dana Green had early in the fall of 2008 in fact assumed the powers of, and had undertaken to act as, CEO of Sage|Kotter; his exercise of these powers was particularly apparent in the recruiting and hiring of individuals to work in the new enterprise, which he did in the offices of and by and through the instrumentality of the Sage Group itself; (d) Dana Green's actions not only facilitated but ultimately led Prof. Kotter to sign Dana Green as the CEO of Sage|Kotter early in 2009, and to give Dana Green but not Ron Worman or the Sage Group any ownership interest or recognized role in the new business and plan.

The fact that Dana Green's numerous breaches of fiduciary duty and of contract in the fall of 2008 were followed by a formal appointment and signing of documents in early 2009 shortly after the expiration of the Sage Group's consulting agreement with Prof. Kotter does not break the chain of causation and damages flowing from his breaches, a chain that both precedes and follows December 31, 2008.

**Rulings on Claims**

**Breach of Contract**: Dana Green breached Section 12 of the Agreement by accepting roles as President, CEO, and managing member of Sage|Kotter both before and after December

31, 2008, and by accepting a 38% equity interest in Sage|Kotter while still being and claiming to be a Manager and Member of the Sage Group, all without the written consent of the Wormans.

**Breach of Fiduciary Duty**: The actions described above also constituted breaches of Dana Green's fiduciary duties to the Wormans. His fiduciary breaches specifically included:

- Using his position as lead with Prof. Kotter to advance his own interests rather than the interests of The Sage Group generally, and in disregard of the interests of Ron Worman as a co-Member, and to fail to explain to the Kotters the extent of his contractual obligaions to his co-Member and existing place of employment;
- Engaging, negotiating and otherwise discussing equity ownership, compensation and employment with Sage|Kotter on his own behalf without disclosing all material facts to Ron Worman and without meaningfully attempting to secure equal rights for Ron Worman or secure his approval;
- Employing the Sage Group's funds, equipment, office space, employees and other assets to develop and secure Sage|Kotter for himself and not for the Sage Group generally or Ron Worman as a co-Member, including such actions as the recruitment and hiring of Randy Ottinger, Kathy Gersch and Matthew Wesley through the instrumentality of the Sage Group but for the benefit of the business opportunity that ultimately became known as Sage|Kotter.

The foregoing actions and omissions took place during a period in which Mr. Green was acting in a fiduciary capacity and knew of his duties and obligations to Mr. Worman as a co-Member, were progressively more frequent and self-serving in the last two months of 2008, and constitute constructive fraud.

**Relief Awarded**

**Damages:** Claimants sought damages and are awarded monetary relief as follows:

- ***The value of Sage\|Kotter as of December 31, 2008:***

The preponderance of the evidence is that while Mr. Green did not oppose or contest the winding up of Sage|Kotter at the end of 2009, he did not direct or control those events; in fact, he appears to have been terminated by the Kotters from his role as CEO for what they determined to be good cause, i.e., his inability to manage relations with partners or co-workers in such a way as to steer clear of litigation or arbitration. Claimants' request that the Arbitrator draw an inference that the wind-up or termination was a ruse managed or manipulated by Mr. Green, or that he planned or plans to resume a leadership role in Kotter International upon the conclusion of this arbitration proceeding, is supported by substantially less than a preponderance of the evidence.

Mr. Green's breaches occurred and caused injury to claimants starting from the inception of Sage|Kotter's *de facto* existence, that is, as early as late August of 2008 but certainly no later than December 31, 2008. The fact that subsequent events led to the ultimate demise of Sage|Kotter at the end of 2009, a period of slightly less than a year, does not alter the fact that a valuable business opportunity had been taken by him, and that his wrongful acts had had their immediate impact, by the end of 2008.

Based on those facts, the problem then presented to the Arbitrator is whether

claimants have established a reasonably reliable and non-arbitrary valuation of that business opportunity. The projections on which claimants and their expert purported to establish a value were not factually sound and were at best speculative. Claimants' expert did not rely on comparable consulting services or other closely-held service businesses for related, similar or otherwise persuasive valuation figures. Claimants also did not meaningfully address value discounts for lack of marketability or for a minority interest-holder's lack of control. Nor did the expert's testimony adequately deal with the fact that Prof. Kotter's flat (and, on the facts of this case, not ill-advised) refusal to issue a license or allow any other outside control over what he considered his intellectual property rendered the business equivalent to one that is terminable at will. Prof. Kotter's reputation arguably could allow for a premium to be charged, a fact that would affect valuation, but that possibility would have to be balanced off by the fact that his retention of absolute control over the "intellectual property" of his business methods would also have caused any reasonable buyer to be extremely unlikely to pay more than a nominal premium.

Claimants have also sought disgorgement of Dana Green's actual compensation in 2009, as allowed by the contract and by the principles of fiduciary law. Thus, even had it been possible on this record to establish a reasonable and reliable dollar value for Sage|Kotter as of December, 2008, a disgorgement award would require that the then present value of anticipated 2009 compensation and earnings in turn be backed out of that business valuation in

order to avoid double-counting. Because total 2009 compensation was $977,125 (i.e., the sum of $827,125 plus $150,000), a valuation of Green's interest in Sage|Kotter would have to be in excess of a figure approaching $977,125 before it would allow any extra value to be awarded to claimants over and above disgorgement. Even the smallest figure argued by claimants (the sum of $608,000 for half of Mr. Green's 38% interest), which was based on a 40% discount rate, was itself excessive because it was founded on a decade of unreasonably high growth projections. Moreover, any ten-year projection must be reduced in recognition of the fact, as explained above, that at its inception the terminability of Sage|Kotter could have allowed no reliable value to be ascribed beyond the first two or three years for persons other than the Kotters. The conclusion is inescapable that no non-arbitrary value can be established for Sage|Kotter that would be measurably in excess of the easily acertained and contractually mandated remedy of disgorgement.

Therefore, the only reasonable measure of damages is not a business valuation *per se* but a requirement that respondent disgorge 50% of the value he in fact received in 2009 for the business opportunity that he had wrongfully taken at the end of 2008.

- ***Disgorgement of Respondent's 2009 Sage|Kotter Compensation***:

Mr. Green received compensation and benefits with a total value of $827,125 from Sage|Kotter in 2009, by taking over an opportunity that both sides agreed had been a commercial opportunity of the Sage Group; claimants will be awarded

one-half of that sum, an award of **$413,562.50.**

- ***Disgorgement of Respondent's 2008 Sage Group Compensation:***

While there is no single point of transition from working on behalf of the Sage Group to serving instead his own personal interest, the evidence is overwhelming that in the last two months of 2008 Mr. Green repeatedly and with increasing frequency breached his contractual and fiduciary duties to the Sage Group and to Ron Worman and served his own personal interests instead. Pro rata compensation to Mr. Green for that two-month period is calculated as $68,641; claimants will be awarded one-half of that sum, an award of **$34,320.50.**

- ***Injury to the Sage Group between January 1, 2009 and June 30, 2010:***

It is plausible that customers were lost because Dana Green was largely absent from the Sage Group. However, the same absence would have occurred had Mr. Green not breached his fiduciary and contract duties and would perhaps have even been increased had he also secured a more direct role for Mr. Worman; the possible loss of customers was a risk that both parties willingly undertook in order to explore opportunities for and with Prof. Kotter. The decreased number of customers cannot be treated as causally related to the breaches of contract or of fiduciary duty. In any event, the evidence also was insufficient to permit the Arbitrator (a) to identify specific customers lost directly due to specific wrongful actions or omissions by respondent, or (b) to exclude or limit the factor of general economic uncertainty in the American economy from the chain of causation.

- ***Disgorgement of compensation received by respondent in exchange for release of claims and of ownership interest in Sage|Kotter:***

Mr. Green received $150,000 in compensation, stated to be from funds remaining at Sage|Kotter at the end of its first year of operations, after which and more likely than not in return for which he released both any claims he may have had against Sage|Kotter and his interest in Sage|Kotter; claimants will be awarded one-half of that sum, an award of **$75,000.00.**

**Declaratory Relief:** Claimants sought declaratory relief under their LLC Agreement and are granted relief as follows:

- ***"Required Sale Event" (Sections 9.5 and 13.12 of the Agreement):***

Mr. Green has by the conduct described above willfully and persistently committed material breaches of the parties' LLC Agreement, and willfully and repeatedly breached fiduciary duties owed to the Sage Group and the Wormans. These breaches, whether taken individually or together, have adversely and materially affected the business and affairs of the Company. It is no longer reasonably practicable to carry on the business or affairs of the Sage Group with Mr. Green, and the determinations and Award entered herein by the Arbitrator constitute a declaration and finding of a "Required Sale Event" under Sections 9.5 and 13.12 of the Agreement.

In the event that the parties are unable to agree on the terms of a sale or, thereafter, the identity of a qualified business valuation expert to determine the fair market value of Mr. Green's Required Sale Units in the manner required and permitted under Section 9.5 of the Agreement, either party may petition the King

County Superior Court to appoint an expert to calculate such value. Mr. Green shall bear the costs and expenses of that expert in proportion to his Units in the Company, as required by the Agreement.

- ***Mr. Green's immediate and future rights and status as Manager and Member of the Sage Group***:

Mr. Green's status as a Manager of the Sage Group and his rights to control or participation under Section 6 of the Agreement are deemed terminated as of December 31, 2008.

Mr. Green's voting rights as a Member of the Sage Group are terminated immediately.

Mr. Green's right to receive any compensation, benefits or value other than as a Required Sale Unitholder in the manner contemplated in Section 9.5 of the Agreement are terminated immediately.

**Costs, Expenses and Fees:** Claimants sought an award of costs, expenses and fees and are granted relief as follows:

- ***Application for award of costs, expenses and fees***:

Because of respondent's repeated and willful breaches of contract and of fiduciary duty in his role as a Managing Member, and because of the evidentiary difficulties created by the spoliation of evidence originally in his possession, custody and control, claimants are entitled to a reasonable award of costs, expenses and fees incurred herein. The specific amount and terms of any such award will be determined after the Arbitrator has received briefing thereon from counsel for both parties.

Claimants shall submit their application for award of costs, expenses and attorneys' fees no later than **the 13th day of August, 2010**; respondents shall submit their response to this application no later than **the 20th day of August, 2010**; claimants may submit a reply no later than **the 27th day of August, 2010**; oral argument will be conducted thereon starting **at 1:30 p.m. on the 31st day of August, 2010**, unless the parties agree on a different date or time or the Arbitrator otherwise orders upon request of either party.

**Respondent's Counterclaim:** At the conclusion of the Hearing on the Merits, respondent largely withdrew his counterclaim for a portion of claimants' 2009 income from the Sage Group. Even had he not done so, and even if the Arbitrator were to ignore the evidence that Mr. Green in December of 2008 intentionally withdrew from and waived all further rights to compensation from the Sage Group, Mr. Green presented no testimony or other evidence sufficient to permit the calculation of a damages figure or appropriate 2009-10 earnings figure for a Member who performed no activity for the Sage Group and who in fact engaged solely in activities designed to promote his own personal interest in Sage|Kotter over the Sage Group during that period. Claimants have sought, and are granted, DISMISSAL of respondent Green's counterclaim.

## FINAL REASONED AWARD ON SUBSTANTIVE ISSUES

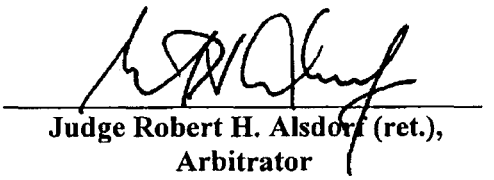
**Based on the foregoing, claimants are awarded:**

1. **The sum of $522,883.00 in damages;**
2. **The declaratory relief set forth and described above; and**
3. **Costs, expenses and fees, in an amount to be determined hereafter.**

**Pursuant to the procedural rules adopted for this proceeding, this Final Reasoned Award on Substantive Issues is not subject to revision, but is to be supplemented on a single remaining issue, that of a reasonable award of costs, expenses and fees, which will be determined on the schedule set forth above.**

**Any and all claims, counterclaims and defenses raised by the parties and not otherwise addressed above are hereby DENIED and DISMISSED.**

**IT IS SO ORDERED, this 28th day of July, 2010.**



**Judge Robert H. Alsdorf (ret.),**
**Arbitrator**

ALSDORF
DISPUTE RESOLUTION

**PRIVATE ARBITRATION PROCEEDINGS**
**BEFORE ALSDORF DISPUTE RESOLUTION**
**SEATTLE, WASHINGTON**

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| RONALD WORMAN and SALLY WORMAN, individually and the marital community comprised thereof,<br><br>Claimants,<br><br>v.<br><br>DANA GREEN, individually and his marital community,<br><br>Respondent. | **Arbitration No. 1519**<br><br>**FINAL RULING ON COSTS, FEES AND EXPENSES SOUGHT BY CLAIMANTS** |

Pursuant to Section 13.12 of the First Amended and Restated Operating Agreement of the Sage Group I, LLC, this matter came on for Hearing on the Merits before the undersigned Arbitrator, commencing on July 12, 2010 and concluding on July 15, 2010. The Final Reasoned



**ALSDORF DISPUTE RESOLUTION**
901 12th Avenue / P.O. Box 222000
Seattle, WA 98122-1090 Tel: 206-228-8575

Award on Substantive Issues (the "Award" or "Reasoned Award")[1] was entered in this matter on July 28, 2010. Claimants were awarded the sum of $522,883 in damages together with certain declaratory relief. The Arbitrator reserved only the issue of appropriate costs, fees and expenses to be awarded to claimants, stating:

> **Costs, Expenses and Fees:** Claimants sought an award of costs, expenses and fees and are granted relief as follows:
> - ***Application for award of costs, expenses and fees:***
> Because of respondent's repeated and willful breaches of contract and of fiduciary duty in his role as a Managing Member, and because of the evidentiary difficulties created by the spoliation of evidence originally in his possession, custody and control, claimants are entitled to a reasonable award of costs, expenses and fees incurred herein. The specific amount and terms of any such award will be determined after the Arbitrator has received briefing thereon from counsel for both parties.

(Award, at p. 15.) Claimants thereafter submitted a memorandum, declarations and exhibits in support of their application for fees, respondent filed opposition briefing, declarations and exhibits, and claimants submitted materials in reply. Oral argument was conducted on claimants' application on September 16, 2010.

Claimants Prevailed in the Face of Respondent's Discovery-related Conduct

At its core, this arbitration addressed claimants' request for termination of the Sage Group. In that, they prevailed, based on contract and fiduciary law. Claimants also sought disgorgement of fees. In that, too, they prevailed, based on contract and fiduciary law. Claimants further sought a constructive trust over Mr. Green's interest in Sage|Kotter. The Kotters dissolved Sage|Kotter and terminated Mr. Green's interest, thereby preventing the formal imposition of a trust thereon, but claimants did nonetheless ultimately prevail on parallel or

[1] For the sake of brevity, all Findings and Conclusions in that Award will not be repeated in this ruling but instead are incorporated herein by this reference.

comparable relief by obtaining judgment for one-half of all value actually received by Mr. Green from his interest in and interaction with Sage|Kotter.

In reviewing claimants' application for costs, fees and expenses, the Arbitrator has carefully considered all the evidence submitted by the parties at the Hearing on the Merits (the "Hearing") along with the additional evidence the parties have now submitted in support of and in opposition to claimants' application, has kept in mind all prior Findings as to credibility of the parties and witnesses, and has carefully considered not only respondent's less than credible testimony before and during the Hearing but also the impact of his incomplete production and spoliation on the cost of presenting and arbitrating all claims, counterclaims and defenses on the merits.

The various claims at issue in this arbitration, as well as the counterclaim, all had a common nucleus of operative fact. All focused on the conduct of Mr. Green. The central time period was almost precisely the last four months of 2008, with the critical time being the last two of those months. For that focused period of time, Mr. Green's personal recollections, his documents, and his electronic records, were essential. Yet Mr. Green persistently claimed a lack of recollection in pre-Hearing discovery, testimony which was largely echoed at the Hearing, his records having largely disappeared without any credible attempt to explain how or why, or even to explain whether he had in fact tried to find them. Mr. Green's conduct rendered it necessary for claimants' counsel to incur substantial time to recreate time lines and interactions as to which only respondent had full personal knowledge and access. It is therefore not surprising that claimants' counsel, who had the burden of proving what only respondent personally and fully knew, would necessarily incur substantially more hours than respondent's counsel, who not only

were primarily defending against claims but also ultimately withdrew respondent's sole counterclaim.

Mr. Green, who was indisputably in a fiduciary position with regard to the Sage Group business opportunity and whose individual actions are at the center of the events material to the claims and counterclaim arbitrated herein, not only put claimants to the burden of proving every material fact but also then directly obstructed them by causing or allowing the destruction or disappearance of electronic and paper documentation and evidence that had been in his possession, custody and control and compounding that burden by presenting sworn testimony that can only be viewed as knowingly incomplete and untrue.

Claimants' Requested Rates, Hours, and Expenses

There is no dispute as to the fact of what hourly rates were charged by claimants' counsel, or as to whether they in fact incurred the time they claimed. However, respondent did dispute the reasonableness of Mr. Goodnight's hourly rate, and did dispute whether claimants' counsel's hours were properly allocated between this arbitration and the related proceeding commenced against respondent by the same counsel on behalf of a Mr. Van Alstine.

The Arbitrator has reviewed the billing records, and the parties' declarations relating to this application, and has determined that the hourly rate charged by Mr. Goodnight has been proved by the preponderance of the evidence to be reasonable in the Seattle legal market for an attorney of his skill and reputation and for the type and quality of work he performed. Moreover, the allocation of time between Mr. Goodnight and Mr. Jarrett acting as his associate was reasonable, and helped preserve an even lower average hourly rate for this fee application.

The Arbitrator has also reviewed claimants' counsel's deduction of certain hours incurred

by them that were primarily of benefit to Mr. Van Alstine, in order to determine whether additional hours should be split with or attributed solely to the Van Alstine matter. It is clear that there were factual overlaps between the two proceedings, and that much of what was done in each case would relate to and be admissible in the other. However, that is not the only issue to consider. A question fundamental to this fee application is whether hours measurably different from the number applied for would have been incurred had there been only this one arbitration and no Van Alstine case. The Arbitrator has reviewed the evidence submitted by claimants to demonstrate that their counsel has already deducted from their fee application time that was useful solely or primarily in the Van Alstine matter. The Arbitrator has concluded from this review that the hours that remain in the billings addressed in this application were reasonably incurred and that substantially the same hours would have had to be incurred in this arbitration to prove claimants' claims even had the Van Alstine case not also been filed. For that reason, the hours remaining in this application are deemed to be appropriate, and no further adjustment downward will be made for hours that may later benefit the Van Alstine case.[2]

Request for Equitable Adjustment

Respondent's counsel has argued for a reduction in fees based on the fact the fact that claimants sought but failed to be awarded a multi-million dollar valuation for respondent's interest in Sage|Kotter.

Given the late 2009 timing of the dissolution of Sage|Kotter, and certain records related thereto, claimants had reason to believe starting early in this arbitration that the dissolution of

[2] Of course, if counsel continues to pursue and ultimately prevails in the Van Alstine litigation, it would not be proper for counsel to be reimbursed a second time in the Van Alstine action for hours already reimbursed herein. As long as the application for any given hour is made only once and is for time that would have been incurred in this case even in the absence of the other case, and those same hours are not later submitted for reimbursement in a second application, then it is proper to have applied for and been awarded reimbursement here.

Sage|Kotter may in fact have been engineered by respondent acting either alone or in collusion with the Kotters, and that after the conclusion of the arbitration Mr. Green would be able to return to Sage|Kotter as an owner and benefit from the value and earnings Sage|Kotter could generate. Only at the end of the Hearing, after all evidence had been admitted, did it become clear that the Kotters had themselves terminated Sage|Kotter and respondent's ownership interest therein. Had Sage|Kotter continued to exist, or had it been established that Sage|Kotter was to be recreated and Mr. Green restored to ownership, a continuing or constructive trust could have been imposed on any present and/or future interest as requested. As it was, however, the final preponderance of the evidence was not only that the Kotters themselves had divested Mr. Green of his own interest in Sage|Kotter but also that the parties' jointly hoped-for valuable business opportunity had always been more illusory than real. Nevertheless, the Arbitrator has concluded that because of the pre-Hearing uncertainty of the evidence it was reasonable for claimants to have pursued claims for a constructive trust and for fifty percent of the value of what under only slightly different circumstances (e.g., a long-term or other enforceable interest in fact in Dr. Kotter's claimed intellectual property) could fairly have been found to have had substantial value.

The bulk of the time incurred in the arbitration related to the central events as to breach of fiduciary duty occurring in the last four months of 2008. Proof of how Mr. Green interacted with the Kotters was essential not only as to fiduciary duty and breach, but also to the existence or absence of an enforceable ownership interest in Sage|Kotter. Only a relatively small portion of the time spent presenting testimony and evidence at the Hearing, perhaps ten percent or slightly more, was actually occupied in proof or counter-proof as to the specific seven-figure valuation

range claimants sought for their lost interest in Sage|Kotter.

The damages and declaratory relief in this case are largely equitable in nature, having been based on substantial violations of fiduciary duty whose true nature was unduly obscured by spoliation of evidence and presentation of incomplete and untrue testimony. Because of the equitable genesis of this relief, the Arbitrator has carefully considered making an equitable adjustment in the fees awarded, in recognition of the time that was spent on an ultimately unsuccessful attempt to obtain a seven-figure award for a 50% share of respondent's interest in Sage|Kotter. The Arbitrator has determined that even though it was reasonable to pursue the claim for what both parties had long believed to be an extremely valuable and even once-in-a-lifetime opportunity with a Harvard professor, applying the ten percent figure for damages valuation Hearing time to all pre-Hearing discovery and preparation would lead to an overall ten percent reduction in the overall fee application and be appropriate as a matter of equity, given the substantial dollar difference between what was sought and what was awarded.

The Arbitrator will therefore deduct $46,019 in fees from the $460,190 applied for,[3] resulting in a reasonable lodestar figure of $414,171. There is no material dispute as to the costs per se, which come to the sum of $66,361.66.

**FINAL RULING AND AWARD OF COSTS, FEES AND EXPENSES**

Mr. Green's conduct in violation of his fiduciary duties was significant and persisted not only throughout the four months in late 2008 critical to the formation of Sage|Kotter, but also throughout the preparation for and the holding of the Hearing herein. That conduct, which was aggravated by spoliation of evidence and the presentation of testimony which greatly increased

[3] Claimants originally sought $462,149, but agreed (Reply, at p. 13) to deduct $1959 from their fee application, resulting in net fee application of $460,190.

the burden on claimants and can only be considered to have been knowingly incomplete and untrue, gives rise to the right to receive an equitable award of costs, fees and expenses in the amounts described above. See, *Li v. Tang*, 87 Wn.2d 796 (1976), *Simpson v. Thorslund*, 151 Wn.App. 276 (2009), and *Henderson v. Tyrrell*, 80 Wn.App. 592 (1996).

Claimants are therefore awarded the sum of **$414,171.00** in fees, plus **$66,361.66** in costs and expenses, for a total award of **$480,532.66**. If this award is not paid in full within thirty (30) days of the date of entry of this ruling, interest shall accrue and be calculated at the statutory rate of 12% per annum from the date of entry.

**IT IS SO ORDERED this 23rd day of September, 2010.**

**Judge Robert H. Alsdorf (ret.),**
**Arbitrator**