No. 94512-8

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

(Court of Appeals No. 47716-5-II)

ALEX SAFRANSKI

Respondent

v.

SULTAN WEATHERSPOON

Petitioner.

RESPONDENT'S ANSWER TO PETITION FOR REVIEW

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I. Introduction

This Court should deny Weatherspoon's Petition for Review, for four reasons. First, Weatherspoon's Petition does not refer to the record for all but one of its factual statements, depriving this Court of an adequate basis for considering the Petition. Second, the challenged Court of Appeals opinion does not conflict with any other published opinion by the Court of Appeals. Third, this case does not present any issue of substantial public importance that needs to be determined by this Court. Finally, the Court of Appeals did not err when it reversed the trial court.

II. Counterstatement of Issues Presented

Weatherspoon's Petition for Review raises three issues:

1. References to Record? RAP 10.3(a)(5) requires that a "[r]eference to the record must be included for each factual statement" in a Petition for Review. With the exception of one undisputed fact, however, Weatherspoon's Petition contains no

references to the record for the rest of his factual statements. Weatherspoon makes several excuses for his violation of this rule, but none of his excuses are availing. Without any references to the record, does this Court have a sufficient basis for even considering Weatherspoon's Petition?

2. Conflicting Opinion? RAP 13.4(b)(2) provides that discretionary review may be proper if "the decision of the Court of Appeals is in conflict with a published decision of the Court of Appeals." Weatherspoon argues this consideration in his Petition for Review, but he fails to demonstrate any conflict. To the contrary, Weatherspoon contradicts his argument by inconsistently claiming his Petition raises an issue of first impression, and by arguing that the two other published opinions are distinguishable. Has Weatherspoon's Petition satisfied this ground for granting review?

3. Substantial Public Interest? RAP 13.4(b)(4) provides that discretionary review may be proper if "the petition involves an issue of substantial public interest that

should be determined by the Supreme Court." Weatherspoon argues this condition, as well. But the Supreme Court and Court of Appeals have issued numerous decisions delineating the contours of standing in the context of shareholder derivative suits, and the case at bar fits well within those contours. Has Weatherspoon's Petition satisfied this ground for granting review?

III. Counterstatement of the Case

In 2001, Sultan Weatherspoon formed a Washington corporation called Duma, Inc. in 2001.[1] Duma was in the business of developing software for video compression.[2] Duma hired Alex Safranski in 2003, and Weatherspoon gave Safranski twenty percent of Duma's stock.[3] By the spring of 2012, however, the relationship between Safranski and Weatherspoon

[1] Clerk's Papers at page 18 ("CP 18")
[2] CP 18
[3] CP 18

had soured.[4] Due to their irreconcilable differences, Weatherspoon and Safranski agreed that Duma's best course of action was to solicit and negotiate a sale of Duma's assets for the highest possible price.[5] Shortly thereafter, Weatherspoon explored the sale of Duma's assets to a company called BMS.[6]

In August of 2012, Duma entered into an Asset Purchase Agreement ("APA") with BMS, wherein Duma sold nearly all its assets to BMS.[7] Under the agreement, BMS agreed to pay Duma "900,000 up front, and an additional $350,000 earnout payment if and when Duma delivered" a certain software product, known as an "i-7 H.264 decoder."[8] BMS made the upfront payment of $900,000 for Duma's assets.[9]

While Duma was negotiating its deal with BMS, Safranski also made a deal with BMS. In June of 2012, Safranski signed an employment agreement with BMS under

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[4] CP 21
[5] CP 22
[6] CP 21
[7] CP 52-53
[8] CP 65
[9] CP 139

which he would receive a "Project Success Bonus" of $160,000 when he "completed the FTGA H.264 Decoder project to the satisfaction of" BMS.[10] Safranski did not tell Weatherspoon about the terms of his employment agreement with BMS.[11]

Roughly a year after the APA was executed, Safranski delivered the decoder to BMS, and BMS paid him the Project Success Bonus of $160,000.[12] BMS then "rejected Duma's i-7 H.264 decoder," and, according to Weatherspoon, "BMS therefore refused to pay the $350,000 earnout" under the APA.[13]

When Weatherspoon found out about Safranski's arrangement with BMS, he brought claims against Safranski for fraud, alleging "Weatherspoon suffered economic damages measured by the value of his interest" in Duma before the sale of its assets, less the amount he received from the sale.[14] In the

[10] CP 65
[11] CP 66
[12] CP 67
[13] CP 67
[14] CP 68

alternative, Weatherspoon claimed he was "entitled to recover his interest in the $350,000 earnout in the amount of $245,000."[15]

Based on these allegations, Safranski brought a motion for summary judgment. Among other grounds, Safranski argued that Weatherspoon did not have standing to sue Safranski. Safranski's motion explained that—based on the allegations in Weatherspoon's own complaint—any direct harm from the alleged fraud was suffered by Duma, which did not receive the full $350,000 earnout payment. As a result, Safranski argued, Weatherspoon's damages were derivative of Duma's damages, and only Duma had standing to pursue the fraud claim.[16]

The trial court denied Safranski's motion.[17] Thereafter, Weatherspoon brought his fraud claim to trial, and the jury

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[15] CP 68 (When he filed that pleading, Weatherspoon had only a 70% interest in Duma, resulting in his claim for only $245,000 of the $350,000 total payment. (CP 67))
[16] CP 74-76
[17] Reporter's Transcript, 4/18/2014 hearing, at p. 38 (RT 4/18/2014 at 38)

awarded Weatherspoon damages against Safranski on the fraud claim. Safranski appealed, and the Court of Appeals, Division II, agreed with Safranski that Weatherspoon's fraud claim was purely derivative of Duma's claim; therefore, Weatherspoon lacked standing to bring that claim. The Court of Appeals further held that Weatherspoon's fraud claim did not fit within any of the recognized exceptions to the well-established rule prohibiting shareholders from bringing claims in their own name that are purely derivative of the corporation's claims. Accordingly, the Court of Appeals ruled that the trial court should have granted Safranski's motion for summary judgment, and it reversed the jury's verdict against Safranski.

IV. Reasons this Court Should Deny Review

A. With One Exception, the Petition Does Not Refer to the Record for Any Factual Statement

RAP 10.3 governs the content of a Petition for Review. In particular, RAP 10.3(a)(5) requires that a "[r]eference to the

record must be included for each factual statement" made in the Statement of the Case. With one limited exception, Weatherspoon's Petition for Review completely violates this rule.

Weatherspoon's Statement of the Case contains three pages setting forth dozens of factual statements. But Weatherspoon supports only one of his dozens of factual statements with a citation to the record. On page 3 of the Petition for Review, Weatherspoon cites the record for the non-controversial statement that "Weatherspoon owned 79.31% of Duma's stock, and Safranski owned 20.69%." The remainder of the factual statements contain no reference to the record.

Thus, Weatherspoon's Petition for Review wholly violates RAP10.3(a)(5). Weatherspoon attempts to blame his violation on Safranski when he complains that "Safranski did not provide the Court of Appeals with a transcript of the trial or the trial exhibits."[18] But this attempt must fail, for several

[18] Petition, p. 4, fn. 6

reasons. First, neither the trial transcript nor trial exhibits were before the trial court when it denied Safranski's summary judgment motion. Second, Safranski's standing argument is based purely on the facts Weatherspoon alleged in his own pleadings. Third, Weatherspoon made a similar argument to the Court of Appeals, that Safranski failed to provide an adequate record for review, but the Court of Appeals rejected that argument. And fourth, Weatherspoon was free to supplement the record on appeal but chose not to do so.

For these reasons, Weatherspoon cannot blame Safranski for Weatherspoon's failure to comply with RAP 10.3(a)(5). Weatherspoon tries to sidestep his failure with the unsupported assertion that: "The summary below is not disputed by Safranski…" But Safranski does dispute Weatherspoon's "summary" of the facts. Similarly, Weatherspoon suggests he does not need to cite to the record because "the Court of Appeals also summarized the fraud." But the Court of Appeals always summarizes the facts in its opinions; this does not

relieve a Petitioner of the duty to cite the record for all factual statements made in a Petition for Review.

Without supporting citations, it is not possible for this Court to evaluate the accuracy of the Petitioner's statement of the case. And without a credible and accurate recitation of the facts, this Court cannot know what issues are truly raised by the Petition, let alone whether those issues meet the criteria for discretionary review. As a result of Weatherspoon's wholesale violation of RAP 10.3(a)(5), this Court should reject his Petition for Review on this basis alone.

B. The Decision Below Does Not Conflict with Any Published Decision of the Court of Appeals

RAP 13.4(b) sets forth the considerations governing the acceptance of discretionary review. Subsection 2 describes one consideration—whether "the decision of the Court of Appeals is in conflict with a published decision of the Court of Appeals." In his Petition, Weatherspoon claims that "the Court

of Appeals' Opinion [sic] conflicts with another Court of Appeals opinion."[19] Nowhere in his Petition, however, does Weatherspoon identify any published decision with which the decision below conflicts.

In his Petition, Weatherspoon cites only two published decisions of the Court of Appeals that deal with the central issue of standing—*Sabey v. Howard Johnson & Co.*,[20] and *Hunter v. Knight, Vale & Gregory*.[21] But Weatherspoon fails to explain how the decision below conflicts with either of these cases. To the contrary, Weatherspoon seeks to factually distinguish *Sabey* and *Hunter*. Finally, Weatherspoon fatally undercuts his "conflict" argument with the inconsistent argument that his case presents this Court with an "Issue of First Impression."[22] If this were truly an issue of first impression, then how could the decision below conflict with any prior published decisions?

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[19] Petition, p. 1
[20] 101 Wn. App. 575, 5 P.3d 730 (2000)
[21] 18 Wn. App. 640, 571 P.2d 212 (1977)
[22] Petition, p. 1

In sum, although Weatherspoon pays lip service to the argument that the decision below conflicts with a published decision of the Court of Appeals, he has not identified a single case that is in conflict, and he contradicts this argument by claiming his case raises an issue of first impression. As a result, the consideration set forth in RAP 13.4(b)(2) is not present in this case.

C. The Petition Does Not Involve an Issue of Substantial Public Interest That Should be Determined by this Court

RAP 13.4(b)(4) provides that—in deciding whether to accept review in discretionary cases—this Court should also consider whether "the petition involves an issue of substantial public interest that should be determined by the Supreme Court." Weatherspoon devotes the vast majority of his Petition to arguing that the Court of Appeals reached the wrong decision, but he devotes almost none if his Petition to demonstrating how his case—as compared to the dozens of

similar cases already decided in Washington—raises any issue of substantial public interest that should be decided by this Court.

The Court of Appeals obviously did not believe this case raised any issue of substantial public interest. In fact, the Court of Appeals did not even believe its opinion in this case had any precedential value. Accordingly, when it issued its opinion, the Court of Appeals decided not to publish it, pursuant to RCW 2.06.040. That statute provides, in pertinent part, that "[a]ll decisions of the court having precedential value shall be published," that "[e]ach panel shall determine whether a decision of the court has sufficient precedential value to be published," and that "[d]ecisions determined not to have precedential value shall not be published." Weatherspoon moved the Court of Appeals to publish its opinion, but the Court of Appeals declined.

Thus, the Court of Appeals clearly did not believe this case had any precedential value. Moreover, even though the

opinion came out in January 2017, there has been no reaction from Washington's practitioners or academia: no articles or commentaries have appeared, nor have any amicus briefs been filed. This is the type of response one would expect when the Court of Appeals issues an opinion—like the dozens before—disposing of another garden-variety case regarding shareholder standing in derivative suits.

Thus, there has been no "hue and cry" indicating this case raises any issue of substantial public importance that should be decided by the Supreme Court. While Weatherspoon's Petition argues this case presents a "clear and compelling need for the Court to address shareholder standing for the first time,"[23] Weatherspoon fails to show such a need.

Moreover, by making this argument, Weatherspoon fails to acknowledge prior decisions of the Supreme Court that have addressed shareholder standing in derivative suits. In

[23] Petition, p. 17

Haberman v. Washington Public Power Supply System,[24] this Court addressed derivative suits in general: "In a derivative suit, a stockholder asserts rights or remedies belonging to the corporation for the corporation's benefit. 12B W. Fletcher, Private Corporations § 5907 (1984)."[25] The Supreme Court also addressed this topic in *Sound Infiniti, Inc. v. Snyder*,[26] in which this Court held that a shareholder had to have a current proprietary interest in the corporation in order to have standing to bring a derivative suit on its behalf.

Thus, contrary to Weatherspoon's Petition, shareholder standing is not an issue of first impression in the Supreme Court. Moreover, there is a long line of published Court of Appeals opinions addressing shareholder standing in derivative suits. This long line is noted in *LaHue v. Keystone Inv. Co.*, in which the Court of Appeals touched on the main contours of this issue:

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[24] 109 Wn.2d 107, 744 P.2d 1032 (1987)
[25] *Id*. at 147
[26] 169 Wn.2d 199, 237 P.3d 241 (2010)

> Defendants Keystone contend that judgment in favor of the stockholders individually is improper. We agree. A stockholder's derivative suit, sometimes referred to as a representative and derivative suit, to enforce a corporate cause of action, is not for the individual benefit of the stockholder. It is established that both the cause of action and judgment thereon belong to the corporation. *Liman v. Midland Bank Ltd*., *Supra; Liken v. Shaffer, Supra. See Goodwin v. Castleton*, 19 Wash.2d 748, 144 P.2d 725 (1944); *Moore v. Los Lugos Gold Mines*, 172 Wash. 570, 21 P.2d 253 (1933). *See generally* 13 W. Fletcher, Private Corporations §§ 5953, 5994 (perm. ed. rev. vol. 1970); Comment, Corporations: Disregard of the Corporate Entity for the Benefit of Shareholders, 1963 Duke L.J. 722; Note, Distinguishing Between Direct and Derivative Shareholder Suits, 110 U.Pa.L.Rev. 1147 (1962); 19 Am.Jur.2d Corporations § 528 (1965).[27]

Safranski has included the lengthy citation to show that shareholder derivative suits—and the law governing them—are nothing new in Washington. As the quote above shows, Washington's courts have been dealing with this area of the law since at least the 1930s, when the Supreme Court issued its opinion in *Moore v. Los Lugos Gold Mines*.[28] In that case, the

[27] 6 Wn. App. 765, 778, 496 P.2d 343 (1972)
[28] 172 Wash. 570, 21 P.2d 253 (1933)

Supreme Court demonstrated its familiarity with the rules governing standing in derivative suits:

> "Where the right to sue exists, it may be exercised by a single stockholder, or by any number of stockholders, or by a minority stockholder, or by the holder of a single share, provided he sues on behalf of other stockholders similarly situated." 14 C. J. p. 937, SS 1455.
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> "In a suit by a stockholder on behalf of the corporation the real controversy is between the corporation and the person whose acts are complained of; the corporation is the beneficial plaintiff, even though it is joined as a party defendant. The suit is for the benefit of the corporation and all the stockholders and not for plaintiff individually. It must be brought in equity; an action at law cannot be maintained." 14 C. J. p. 938, SS 1457.[29]

Since *LaHue*, there has been a long line of cases involving shareholder derivative suits, extending from *LaHue* and its progeny, to *Bolt v. Hurn*,[30] to *Gustafson v. Gustafson*,[31] to *Sabey v. Howard Johnson Co.*[32]

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[29] *Id*. at 598
[30] 40 Wn. App. 54, 696 P.2d 1261 (1985)
[31] 47 Wn. App. 272, 734 P.2d 949 (1987)
[32] 101 Wn. App. 575, 5 P.3d 730 (2000)

In sum, there is no shortage of published cases in Washington establishing the rules governing standing in shareholder derivative suits. There are literally dozens of appellate opinions addressing these rules, and Washington's practitioners and academia are not clamoring for guidance or decrying a lack of clarity in this area of the law. Because it is no different from other shareholder derivative cases, Weatherspoon's Petition does not raise any issue of substantial public importance that should be decided by the Supreme Court.

D. The Court of Appeals did not Err

As noted above, Weatherspoon devotes almost the entirety of his Petition to convincing this Court that the Court of Appeals erred in reversing Weatherspoon's judgment for lack of standing. In his Appellant's Brief, Safranski has already briefed the vast majority of Weatherspoon's arguments, and Safranski will avoid unnecessary repetition in this Answer.

Instead, Safranski will focus on the new arguments Weatherspoon raises in his Petition.

For example, in his Petition, Weatherspoon argues for the first time that Safranski failed to raise the standing issue in his summary judgment motion to the trial court. On page 7 of his Petition, Weatherspoon misleadingly suggests that Safranski's only argument to the trial court was that "the evidence was insufficient to show that Safranski had a duty to disclose the $160,000 bonus to Weatherspoon." What Weatherspoon conveniently omits, however, is that Safranski also argued in his summary judgment motion—citing *Sabey* and *Hunter*—that Weatherspoon lacked standing because the fraud claim belonged to Duma, not Weatherspoon.[33]

Weatherspoon's Petition also tries to create the false impression that Safranski made a damaging admission during the appellate argument—that Weatherspoon might have standing if he had sold his shares, rather than Duma selling its

[33] This is shown clearly on pages 4-6 of Appendix E to the Petition, which is also contained in the Clerk's Papers at pages 85-87.

assets, to BMS. Weatherspoon describes a sale of stock by the shareholder, versus a sale of assets by the corporation, as a "distinction without a difference," but he could not be more wrong. The law is clear: in order to have a direct claim, Weatherspoon must have suffered some damage that is separate from his ownership of the shares and qualitatively different from the damage suffered by the other shareholders. If Weatherspoon, and only Weatherspoon, were fraudulently induced to sell only his shares of Duma, he may have direct standing to sue the wrongdoer.

But Weatherspoon's pleading complained that Duma was harmed when it was not paid the full purchase price for its assets, which Weatherspoon admits affected him only in proportion to his percentage of ownership of Duma. Thus, all other shareholders suffered the exact same damage in proportion to the ownership of their shares. This is a classic derivative claim that must be brought on behalf of the corporation, not directly by a single shareholder.

In pressing his arguments, Weatherspoon continues to disregard the separate existence of Duma. For example, Weatherspoon suggests he "lost control of all of the corporation's assets" as a result of the fraud; but the assets belonged to Duma, not Weatherspoon. Similarly, Weatherspoon complains the fraud caused him to lose "control" of Duma; but Weatherspoon did not lose control of Duma—he owned exactly the same majority interest in Duma after the asset sale as he owned before the asset sale. Thus, contrary to Weatherspoon's argument, there is a principled difference between Weatherspoon selling his shares, versus Duma selling its assets.

Weatherspoon's Petition also argues, for the first time, that there is a ***third*** exception to the general rule that shareholders cannot bring direct claims for harm to the corporation, and that the Court of Appeals failed to consider this other "common law exception." Weatherspoon did not present this argument to the Court of Appeals. Even if he had,

this argument has no merit because the exception he now refers to applies only if "full relief to the stockholder cannot be had through a recovery by the corporation."[34] But if Duma had brought its own suit and made a full recovery, then Weatherspoon would have received full relief by receiving his proportionate share of the corporation's recovery.

Finally, in a last-ditch effort to obtain review, Weatherspoon faults the Court of Appeals for reversing the trial court's denial of Safranski's summary judgment motion, arguing that the trial court's action was not reviewable for procedural reasons. But even if the Court of Appeals had erred in that regard, which it did not, Weatherspoon has failed to show how this purported error meets the considerations for granting review.

[34] Petition, p. 16, quoting 19 Am. Jur. 2d Corporations §1956 (2004)

V. Conclusion

For the foregoing reasons, Safranski respectfully requests this Court deny Weatherspoon's Petition for Review.

Dated: June 12, 2017

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 12, 2017, I served the foregoing **Respondent's Answer to Petition for Review** on:

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by the following indicated method or methods:

☐ **E-mail.**

☐ **Facsimile communication device.**

✠ **First-class mail, postage prepaid.**

☐ **Hand-delivery.**

☐ **Overnight courier, delivery prepaid.**

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