No. 98604-5

SUPREME COURT
OF THE STATE OF WASHINGTON

JERRY KESSELRING,

Petitioner,

v.

DONALD KESSELRING, and JUDITH G. KESSELRING, husband and wife and the marital community comprised thereof, KEITH KESSELRING and MARY KESSELRING, husband and wife and the marital community comprised thereof, ESTATE OF BRAD D. KESSELRING, and KESSELRING GUN SHOP, INC., a Washington corporation,

Respondents.

RESPONDENTS KEITH AND MARY KESSELRING'S ANSWER TO PETITION FOR REVIEW

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

RULES AND REGULATIONS

OTHER AUTHORITIES

I. INTRODUCTION

The Court of Appeals applied the plain language of the Washington Corporations Act to a unique (if tragic) set of facts, and based on findings supported by substantial evidence, affirmed the trial court's equitable determinations in this derivative action in accordance with established case law. Further review is not warranted because Division One's unpublished opinion does not conflict with any decision of this Court or the Court of Appeals, properly applied the relevant statutes, and raises no issues of substantial public interest for determination by this Court.

II. RESTATEMENT OF THE CASE

Although giving lip service to the correctness of Division One's recital of facts in its unpublished opinion (Petition 1), petitioner continues to myopically mischaracterize the history of Kesselring Gun Shop (KGS). The trial court entered 92 findings of fact, following an 11-day trial; petitioner challenged fewer than one-third of them on appeal. The salient factual findings relied upon by the Court of Appeals in affirming the trial court's decision, and the evidence supporting challenged findings, are summarized here:

A. Respondents did their best to correct the consequence of years of mismanagement of the family gun shop by their parents and deceased brother. They were ultimately unsuccessful and the business was closed and liquidated.

The parties to this action are brothers. They acquired their ownership interests in KGS, the family gun shop opened in 1947 and operated by their father Ron until 2009, by gift from their parents. (FF 1.1, 1.5 CP 2553-54) Although he benefited from his ownership interest in KGS, petitioner Jerry Kesselring did not work at KGS, and as the events that led to the ultimate dissolution of the corporation unfolded, resisted efforts to assist in management of the business. (FF 1.8, CP 2554) Respondents Don and Keith Kesselring, as well as the parties' brother Brad, did work at KGS, and it provided their livelihood. (FF 1.14, 1.16, CP 2556)

Although KGS had been formally incorporated in 1971, a "sole proprietorship mentality" continued, no different "from most family owned and operated businesses that incorporate but continue to operate the same way they operated when they were a sole proprietorship." (FF 1.10, CP 2554-55) For instance, KGS paid their father Ron $3,500 a month after his retirement until his death in November 2016. (FF 1.46, CP 2563) KGS also paid many other expenses for the father; the trial court found no evidence that these

monies were not paid back consistent with KGS' reimbursement policy or that Jerry's interest in KGS was reduced by these practices. (FF 1.59-62, CP 2566-67; RP 263-64, 1035-39, 1677-78, 1696-97) These are among the "extensive personal expenses from corporate resources" that petitioner complains proves the "*multiple* ways" respondents "breached their fiduciary duties to KGS." (Petition 4) (emphasis in original)

Brad took over their mother Frances' duties, including the responsibility for financial matters and operations, after their mother died in 2003. (FF 1.15, CP 2556) When the parties' father retired in 2009, Keith and Don "inherited" the management of KGS – and its problems with the ATF, under-reported income and inventory dating back to the 1960s, and, most tragically, the consequence of brother Brad's embezzlement and subsequent death by suicide in October 2009. (FF 1.22, CP 2557, FF. 1.54, CP 2565; RP 258, 728, 822-23, 1692-95) Taking these problems in turn:

ATF had begun inquiring into potential violations of firearm regulations by KGS in 2005, when it began a detailed audit of KGS operations going back to the 1960s, issuing a Report of Violations while the parties' father was still running KGS in 2006. (FF 1.30, CP 2559) After first learning of the ATF Report and Notice in June 2010,

Keith (who was then battling brain cancer) met with ATF representatives in July 2010, received approval for a Compliance Plan he had developed, and implemented further measures to meet compliance requirements in 2011. (FF 1.32-1.32, CP 2560) Nevertheless, the ATF revoked KGS' federal firearms license on October 9, 2012; on advice of counsel the license was surrendered. (FF 1.34-1.35, CP 2560-61)

The trial court found that "[t]he loss of license was a result of two generations of informal management of a highly lucrative business. . . . The loss of the ATF License could not be laid at the feet of Donald Kesselring and Keith Kesselring because of any actions they took, but instead it is a result of a business that never really ascended beyond its origins." (FF 1.86, CP 2573) Substantial evidence supports this finding. (RP 723-25, 767-69, 1506-08)

KGS' informal management processes also had allowed its inventory value to be substantially underreported for decades; the actual inventory value was substantially larger than the inventory value that had been reported to the IRS. (FF 1.19, CP 2557) Because the under-reported inventory resulted in under-reporting of income to KGS, KGS had to report income in tax years 2009 through 2012

that created additional significant tax liability for the shareholders. (FF 1.19-1.20, CP 2557)

The trial court found that Jerry suffered no damage and that there was no loss in the value of KGS due to the inventory valuation restatement. (FF 1.69, CP 2569) This challenged finding was also supported by substantial evidence. (RP 1242-46; Exs. 180, 196) KGS gave Don and Keith bonuses to help pay their additional federal income taxes resulting from the restatement of inventory valuation. These are the "expansive compensation and bonuses" that petitioner complains of. (Petition 4)[1] The trial court found that respondents' compensation was reasonable. (FF 1.57, CP 2565)

The value of KGS and its stock as an ongoing concern were significantly reduced following ATF's revocation of KGS' license by the need to liquidate. (FF 1.79, CP 2571-72) During the winding down of the business, inventory was sold at a discount, and all three shareholders lost significant value in what had been an ongoing business. (FF 1.39, CP 2561)

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[1] Jerry did not have to pay any added assessed tax liability related to the inventory value restatement. Instead, he was able to take losses from KGS against other income. The trial court awarded him judgment for professional tax advice related to his assessed tax liability (FF 1.57, CP 2565), but not for his claimed personal time in doing his taxes. (RP 1304-05, 1312; Exs. 88, 208-12)

These troubles for KGS thus did not begin, but only surfaced, after the parties' brother Brad took his own life, shortly after it came to light that he had been taking substantial sums from KGS and using KGS funds and credit to purchase personal items. Brad died in October 2009 leaving a large unresolved and unreimbursed debt to KGS. (FF 1.23, CP 2557-58) After his death the family also learned that Brad was the father of an infant who stood to inherit his estate, including his interest in KGS. (FF 1.23, CP 2557-58)

In a settlement with Brad's estate, KGS eventually redeemed Brad's shares for the amount it was determined Brad had embezzled that he had not paid back before his death, and other financial claims KGS had against him. (FF 1.24, CP 2558) The trial court found that Brad's improper charges, including the tractor and truck Brad purchased with KGS funds that petitioner relies upon as proof of respondents' *multiple* breaches of their fiduciary duties (Petition 4) (emphasis in original), were accounted for and made part of this arms-length agreement between Brad's estate and KGS. (FF 1.54, CP 2565; RP 264-65, 1424-29, 1694; Exs. 56, 98) Jerry received additional shares in KGS (and ultimately, more cash when KGS was liquidated) as a result of the redemption of Brad's shares. (FF 1.54, CP 2565)

B. The Court of Appeals affirmed the decision of the trial court, after trial and acting in equity, rejecting Petitioner's claims for more than the $750,000 he had already received for his interest in KGS.

Jerry demanded that he be bought out of his interest in KGS after Brad died, claiming he was entitled to over $3 million. (FF 1.25, CP 2558) The value of Jerry's shares became "entangled" with the process of recovering losses from Brad's Estate, the valuation and repurchase of Brad's shares (FF 1.26, CP 2558), and eventually, the winding down of the business and sale of inventory at a discount, which caused all three shareholders to lose significant value. (FF 1.39, CP 2561) Jerry eventually received over $750,000 after he forced KGS into receivership; the trial court in an unchallenged finding found that because KGS was Don's and Keith's livelihood, the loss of value most directly impacted them. (FF 1.39, CP 2561) Nevertheless, after the receiver assigned to Jerry any remaining derivative claims, he pursued his surviving brothers in this litigation.

After 11 days of trial, the trial court concluded that it "would be inequitable for the court to hold Keith Kesselring and Donald Kesselring responsible for management practices and problems that were created . . . prior to their assuming a position of control, and that they were unable to correct despite their efforts." (CL 2.12,

CP 2576) Division One affirmed in an unpublished opinion and then denied Jerry's motion to publish.

III. ARGUMENT IN OPPOSITION TO REVIEW

A. The Court of Appeals applied the plain language of the Washington Corporation Act, consistent with legislative intent and established case law.

The Court of Appeals' unpublished opinion did not endorse a "lower fiduciary duty standard" for the officers and directors of a family-held corporation. (Petition 3) To the contrary, the Court of Appeals interpreted the plain language of the Corporations Act in holding that the trial court properly considered whether the directors of KGS discharged their duties "(a) in good faith; (b) [w]ith the care an ordinary prudent person in a like position would exercise under similar circumstances; and (c) in a manner the director reasonably believes to be in the best interests of the corporation." RCW 23B.08.300, quoted Opinion 11.

The plain language of the statute thus imposes a standard of care based on the particular corporate circumstances. It is supported by the legislature's intent to recognize that the standard of care requires consideration of "such factors as the size, complexity, urgency, and location of activities carried on by the particular corporation," as well as "the background, qualifications, and

management responsibilities of a particular director." (Op. 12, quoting 2 Senate Journal, 51st Leg., Reg. Sess., at 3042-43 (1989)) *Accord*, American Law Institute, *Principles of Corp. Governance* § 4.01, comment e (1994) ("the nature and extent of the functions and obligations of a director or officer will vary depending upon such factors as the nature of the business, the urgency and magnitude of a problem, and the corporation's size and complexity.").

This standard of care is neither new nor novel. It "embodies long traditions of the common law," and is uniformly applied under a host of other statutes and in the law of torts. 2 Senate Journal at 3042. *See, e.g.,* RCW 43.33A.140 (state investment board); RCW 48.05.370 (officers and directors of an entity holding a controlling interest in an insurer); *Hendrickson v. Moses Lake Sch. Dist.*, 192 Wn.2d 269, 277, 428 P.3d 1197, 1202 (2018) (tort duty of "reasonable care under the circumstances."). Rather than providing a fixed standard applicable in all situations, this standard of reasonable care "express[es] the opinion of society as to what should be done or left undone by a reasonable man under the circumstances of the particular case." *Restatement (Second) of Torts* § 285 (1965)

Further, Jerry's attempt to lay this family business's decades of informal management at the feet of his brothers as a matter of law

and notwithstanding the trial court's contrary findings of fact, ignores that in Washington, like most states, "no liability for damages will occur unless a challenging party also sustains the burden of proving that a breach of duty of care standards was the legal cause of loss to the corporation." American Law Institute, *Principles of Corp. Governance* § 4.01 (1994). Thus, each of the cases petitioner cites for the proposition that "Washington law has long recognized that officers/directors of corporations are fiduciaries for the corporations and the corporate shareholders they serve" (Petition 3) turns on whether the fiduciary profited, at the expense of other shareholders or the corporation, from his or her actions. This is true both in cases where relief was granted, *see, e.g., Wool Growers Serv. Corp. v. Ragan*, 18 Wn.2d 655, 692, 657, 140 P.2d 512 ("large sheep operators" who held majority of shares in corporation "breached their trust for their own private gain" in negotiations and settlement with minority shareholders, "uneducated Spaniard" sheepherders "who could neither read English nor write it"), *reh'g denied*, 18 Wn.2d 655 (1943), and where it was not. *Leppaluoto v. Eggleston*, 57 Wn.2d 393, 402, 357 P.2d 725 (1960) (although shareholder "in chartering his own equipment to the joint venture without the knowledge or consent of [the other shareholder],

breached a fiduciary obligation," in absence of evidence he personally profited, no basis for liability to corporation); *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wn.2d 375, 384, 391 P.2d 979 (1964) ("a corporate officer will be held to strict accountability for any individual profits made by him in dealing with assets of the corporation . . . but that rule . . . does not justify the conclusion that appellants received any secret profits," quoting *Bay City Lumber Co. v. Anderson,* 8 Wn.2d 191, 205, 111 P.2d 771 (1941)) (all cited Petition 3).

Here, the trial court found in an unchallenged finding that respondents did not benefit from and in fact were harmed far more than petitioner by the consequences of the failures of their predecessors, which led to the loss of the ATF license and eventual liquidation of KGS. (FF 1.39, CP 2501) And although it is true that corporate officers and directors can be liable for the misconduct of other corporate directors, they are entitled to rely on information from other officers or directors. RCW 23B.08.300(2)(a), .420(2)(a). This is not a case where the respondents failed "to be involved in and familiarize herself with the business," like *Senn v. Nw. Underwriters, Inc.*, 74 Wn. App. 408, 417, 875 P.2d 637 (1994) (Petition 11-13). To the contrary, the trial court heard and relied

upon extensive evidence of respondents' efforts to take control and correct both firearms handling and accounting by employees, and made specific findings, amply supported by the evidence, that in particular Brad's misconduct was "easily concealed" (FF 1.67, CP 2568), that "it would be inequitable to charge Don and Keith with Brad's theft," and that in any event the known losses to KGS were recovered in the settlement with Brad's estate from which Jerry benefited. (FF 1.66, CP 2568)

Finally, contrary to petitioner's argument (Petition 9), Washington courts have long recognized that the good faith conduct of officers and directors in a closely-held corporation cannot as a matter of law subject them to liability to minority shareholders. Respondents' duties as corporate officers and directors were subject to the "business judgment" rule, which required only that they act in good faith. "In considering the actions of a corporate officer, . . . the business judgment rule . . . shields the corporate officer from liability so long as he acts in good faith without a corrupt motive." *Para-Medical Leasing, Inc. v. Hangen*, 48 Wn. App. 389, 396, 739 P.2d 717, *rev. denied*, 109 Wn.2d 1003 (1987). Application of that rule by the trial court did not somehow subject respondents to a "lower,"

"reduced," or "diminished" fiduciary duty, as argued by petitioner in support of review. (Petition 1, 7, 9, 14)

The Court of Appeals' holding that "[i]n determining the standard of care under RCW 23B.08.300 and RCW 23B.08.400, the trial court could consider the characteristics" of the particular corporation the officers and directors serve (Op. 13) neither conflicts with any case law nor raises a public policy issue, much less one of substantial public interest that merits review in this Court. RAP 13.4(b)(1), (2) and (4).

B. The Court of Appeals' affirmance of the trial court's exercise of discretion under these particular facts in an unpublished decision does not warrant further review.

Division One relied on established law in reviewing the trial court's extensive, largely unchallenged, findings of fact to hold that the trial court did not abuse its equitable discretion in refusing to reallocate the losses to the corporation "in a different way than the shareholder's ownership interests dictated." (Op. 16-18, citing *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wn. App. 502, 520, 728 P.2d 597 (1986), *rev. denied*, 107 Wn.2d 1022 (1987)). Nothing in the Court of Appeals' unpublished opinion reviewing the evidence in support of the trial court's decision, and properly giving weight to the

trial court's first-hand consideration of the idiosyncratic and tragic circumstances of this family business, warrants further review.

First, the Court of Appeals followed settled law in concluding that the shareholder derivative remedy sought by Jerry is an equitable remedy, reviewed for abuse of discretion, that authorizes the trial court under exceptional circumstances to reallocate an award to the corporation. (Op. 8-9) *See LaHue v. Keystone Inv. Co.*, 6 Wn. App. 765, 777, 496 P.2d 343, *rev. denied*, 81 Wn.2d 1003 (1972) (Petition 8); *Interlake Porsche*, 45 Wn. App. at 520 (Petition 8, 17). The appellate court's unpublished opinion relying upon that standard does not conflict with any decision of this or the intermediate appellate courts and does not warrant review under RAP 13.4(b)(1) or (2).

Second, that the Court of Appeals then affirmed the trial court's consideration of the unique circumstances of this case in its undisputed findings of fact, including "the fact that [Donald and Keith] did not become directors or officers until 2009 and the ATF violations went back as far as 1968," that "the regulatory mismanagement of KGS preceded Donald and Keith's time as officers and directors," and that "Keith made significant efforts to get KGS ATF compliant," while "Jerry resisted service on the Board of

Directors" (Op. 17), similarly raises no issues warranting review. The tragic events that befell the Kesselring family and its gun business are entirely idiosyncratic and present no issues of substantial public interest. RAP 13.4(b)(4).

C. Petitioner's belated request for fees on appeal does not raise further grounds for review.

Jerry did not request fees in the trial court, and on appeal asserted a "common fund" theory for recovery of his appellate fees. (App. Br. 41) Far from protecting the interests of or providing a value to the corporation, Jerry cost his surviving brothers hundreds of thousands of dollars defending against his self-centered pursuit of a final pound of monetized flesh for his parents' and dead brother's claimed mismanagement of the family business. Having affirmed the equitable decision below, the Court of Appeals' failure to directly address petitioner's belated request for fees on appeal raises no grounds for review in this Court.

IV. CONCLUSION

For almost a decade, and despite having received over three-quarters of a million dollars from the family business he did nothing to help save, and much to destroy, petitioner has tried to make his surviving brothers pay for his family's misfortunes, which affected

them far more than him. The trial court wisely sought to bring closure to this unfortunate family conflict, and the Court of Appeals wisely affirmed its decision. The Court of Appeals' unpublished opinion affirming the trial court's discretionary balancing of the equities to deny petitioner's claim for extraordinary derivative relief when he suffered no "special injury," where his surviving brothers acted in good faith and did not put their own interests above those of the family business or otherwise breach their fiduciary duties, raises no issues for further review in this Court. This Court should deny review.

Dated this 31st day of July, 2020.

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DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on July 31, 2020, I arranged for service of the foregoing Respondents Keith and Mary Kesselring's Answer to Petition for Review, to the Court and to the parties to this action as follows:

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DATED at Seattle, Washington this 31st day of July, 2020.

Andrienne E. Pilapil

SMITH GOODFRIEND, PS

July 31, 2020 - 11:58 AM

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