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Court of Appeals No. 53991-8-II

SUPREME COURT OF THE STATE OF WASHINGTON

REAL CARRIAGE DOOR COMPANY, INC., ex rel. SCOTT T. REES,
MARDIE A. BRODERICK and JEREMY BRODERICK,
Shareholders Thereof; and SCOTT T. REES, MARDIE A.R. BRODERICK
and JEREMY E. BRODERICK, Individually,

Respondents,

v.

DON T. REES,

Petitioner

ANSWER TO PETITION FOR DISCRETIONARY REVIEW

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I. INTRODUCTION

The petition for review should be denied because the Petitioner Don Rees fails to show a conflict with a decision of the Supreme Court or a question of substantial public interest. The Court of Appeals applied the correct standard of review when it evaluated whether substantial evidence supports the trial court's findings of fact and whether those findings support its conclusions of law. *Real Carriage Door Company, Inc. et al. v. Don T. Rees*, 53991-8-II, 2021 Wash. App. LEXIS 1201 (Ct. App. May 11, 2021) ("Opinion") at 5-6. The Court held that undisputed evidence showed the Petitioner converted the profit that all shareholders would have received as dividends proportionate to ownership and paid it all to himself -- the very conduct defined as minority oppression in *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 713, 64 P.3d 1 (2003). Opinion at 9.

Petitioner argues the Court of Appeals decision will lead to "a tidal wave" of lawsuits by shareholders unhappy with their distributions. Petitioner's argument ignores the ruling in *Scott*, followed by the Court of Appeals here, that majority shareholders need only justify their decision if the court has found illegal, fraudulent, or oppressive conduct. *Scott*, 148 Wn.2d at 708-90; Opinion at 11. There is no reason to fear oppressive conduct will suddenly become rampant as a result of this decision.

II. ISSUES PRESENTED

1. Should review be denied when the Opinion follows the correct standard of review as set forth in *Am. Nursery Prods. Inc. v. Indian Wells Orchards*, 115 Wn.2d 217, 797 P.2d 477 (1990), by determining whether substantial evidence supports the trial court's findings of fact and whether those findings support its conclusions of law?

2. Should review be denied when the undisputed evidence shows that Don Rees siphoned off the profits of a closely held corporation solely for his own benefit, to the detriment of minority shareholders, which is the exact conduct the Court in *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 64 P.3d 1 (2003), defined as oppressive, and that he did so for no business purpose?

3. Should review be denied when the Opinion correctly holds that the burden only shifts to majority shareholders to show a reasonable business justification if their conduct is found to be illegal, fraudulent, or oppressive, and thus the Opinion does not establish a new standard for minority oppression and thereby give rise to an issue of substantial public interest?

III. COUNTERSTATEMENT OF THE CASE

In the beginning, Real Carriage Door Company, Inc. (the "Company" or "RCDC") was a family business in which Beth Rees and

Petitioner, Don Rees, their children, Scott Rees and Mardie Broderick, and their son-in-law, Jeremy Broderick, all worked. RP 6/18/19 at 7:21-8:7.

Wanting to create a family business with the children eventually taking control, the parents gave Company stock to their children. From 2010 through 2013, Beth and Don Rees made gifts of shares of stock to their son, Scott Rees, of six percent; to their daughter, Mardie Broderick, of 3.1 percent; and to their son-in-law, Jeremy Broderick, of 2.9 percent. RP 6/17/19 at 29:18-30:5. Beth Rees made approximately 59 percent of those gifts, and Don Rees approximately 41 percent. Ex. 1 at ¶8. After the gifting of shares, the parents owned 88 percent of the Company, while their children and son-in-law owned 12 percent.

In April 2014, Don Rees filed for divorce from his wife, Beth. Ex. 1 at ¶14. Scott, Mardie and Jeremy were against the divorce, and all took Beth's side, which greatly angered Don Rees. RP 6/17/19 at 32:4-34:15; 56:24-57:3. From that point on, Don Rees created an "oppressive environment" that made it very difficult for Scott and Jeremy to continue working for the Company. RP 6/17/19 at 32:9-16; 57:7-14. (Mardie Broderick had ceased working for the Company several years earlier when her child was born, but occasionally worked part-time. RP 6/17/19 at 51:14-20.) Don Rees's actions created an atmosphere of distrust between himself and Scott and Jeremy. RP 6/17/19 at 32:9-11; 57:7-10; 81:7-17. His strategy

worked, as both Scott and Jeremy left the Company in late 2014. RP 6/17/19 at 37:12-14; 58:24-59:2. However, Scott, Mardie and Jeremy all retained their shares of stock in the Company. RP 6/17/19 at 37:15-18; 59:3-6.

Don Rees acquired Beth's shares of stock in the divorce, thereby owning 88 percent of the Company's stock. RP 6/18/19 at 36:25-37:6. Don Rees is also the President and Chief Executive Officer of the Company. RP 6/18/19 at 126:23-25. Thus, Don Rees had complete control of the Company after the divorce became final in April 2015. Exs. 5 and 103.

Prior to the divorce, the Company distributed dividends each year to every shareholder. After the divorce, however, Don Rees directed the Company to stop distributing Company profits in the form of dividends to shareholders, while simultaneously and dramatically increasing his own salary, from \$120,000 the year before the divorce was filed to \$1,216,367 the year after the divorce. Ex. 14 at p. 3; RP 6/17/19 at 38:4-16.

Before the divorce, the Company routinely made pro rata dividend distributions (based upon stock ownership) to all shareholders on a quarterly basis so the shareholders would have funds available to pay taxes on the Company's income. RP 6/17/19 at 38:13-22. After the divorce, Don Rees caused the Company to stop paying dividends to his children and son-in-

law, who were then forced to use their own funds to pay their pro rata share of the taxes on the Company's profits¹. RP 6/17/19 at 38:13-22.

Don Rees, however, took bonuses and increased salary from the Company so that he could use those funds to pay his share of the Company's taxes. As the Company's bookkeeper, Jennifer Pomeroy, testified at trial:

It was decided that Don would take a bonus to cover his -- his estimated tax payments instead of taking a distribution. If he took a bonus, then he didn't have to pay out a distribution to the kids to match their percentage of ownership.

RP 6/17/19 at 74:23-75:2.

After the divorce became final in 2015, Don Rees significantly increased his salary. In the five years prior to his divorce, his annual salary from the Company was:

2010	\$64,727
2011	\$96,000
2012	\$105,000
2013	\$120,000
2014	\$120,000

which averaged \$101,145 per year. Ex. 14 at p. 3; RP 6/17/19 at 112:16-21.

After the divorce, Don Rees's salary increased to an average of \$994,838 per year:

¹ The Company and its shareholders had made an election pursuant to §1362 of the Internal Revenue Code of 1986 to be taxed as an S Corporation whereby the shareholders would be taxed prorata on the Corporation's profits, rather than the Corporation being taxed.

2015	\$1,216,367
2016	\$834,562
2017	\$973,926
2018	\$954,500

Ex. 14 at p.3; RP 6/17/19 at 113:12-17.

The Company bookkeeper testified that Don Rees wanted 100 percent of the Company's shares, and that his reason for not paying dividends was to force his children and son-in-law to have to pay taxes on their proportionate share of the Company's net income out of their own money and to force them into selling their shares of stock to him at less than their fair-market value. RP 6/17/19 at 73:21-74:5.

IV. ARGUMENT FOR DENYING REVIEW

Review should be denied because the Court of Appeals correctly held that the evidence at trial did not support the trial court's findings of fact on the issue of minority oppression, and its findings did not support the conclusions of law. Contrary to the Petitioner's arguments, the Opinion applies the standard of review articulated in *Am. Nursery Prods. Inc. v. Indian Wells Orchards*; is consistent with the decision in *Scott v. Trans-System, Inc.*; and does not hold that failure to issue a dividend constitutes oppression as a matter of law "even though the minority shareholder cannot demonstrate that there was oppressive conduct." Petition for Review ("Pet. Rev.") at 2.

A. The Court of Appeals applied the correct standard of review.

Petitioner misunderstands the Court of Appeals opinion when he claims it conflicts with *Am. Nursery Prods., Inc. v. Indian Wells Orchards*, 115 Wn.2d 217, 797 P.2d 477 (1990). The Court of Appeals did not review *de novo* the reasonableness of Petitioner's decision to discontinue shareholder dividends and increase his own salary. Rather, the Court of Appeals held that substantial evidence does not support the factual findings of the trial court: "Nothing in the record supports a finding that because the Appellants no longer were working at RCDC, Rees was justified in discontinuing the distribution of dividends and increasing his annual salary by \$700,000 to \$1 million." Opinion at 9-10.

The Court of Appeals applied the correct standard of review, which is to determine whether a trial court's findings of fact are supported by substantial evidence, and if so, whether the findings support its conclusions of law. *Am. Nursery Prods.*, 115 Wn.2d at 222 (citation omitted). "Substantial evidence is evidence sufficient to persuade a fair-minded person of the truth of the declared premise." *Id.* (citation omitted). Application of this standard of review requires the Court of Appeals to review the record for evidence to support the trial court's factual findings.

Petitioner's argument centers on the Court of Appeals' discussion of the trial court's Finding of Fact No. 20, which states:

In 2015 RCDC ceased distributing dividends to shareholders and started paying Defendant Rees an increased salary because Defendant Rees now either performed or oversaw the previous duties of his ex-wife, Beth Rees, and the Plaintiff's [sic], Scott Rees, Mardie Broderick and Jeremy Broderick, who all were no longer employed at RCDC.

Pet. Rev. at 13, n 4. The Opinion agrees there was evidence that Don Rees “now either performed or oversaw the previous duties of the Appellants after they no longer were employed at RCDC.” Opinion at 9. What the Court did *not* find was evidence that justified Don Rees’s decision to discontinue all payment of dividends of profit, and to redirect the profit solely to himself.

Rees’s stated reason for discontinuing payment of dividends was that the minority shareholders no longer worked for the Company. Opinion at 4 (citing RP at 52, 68). The trial court made factual findings in its conclusions of law 3 and 4 that the corporation’s practice was to make “gifts of dividends” and there was “an implied agreement to pay the minority stockholders a salary and *gifts of dividends* only during the period of their employment . . .” Opinion at 10 (emphasis added by Court of Appeals).

The Court of Appeals found no evidence in the record – much less substantial evidence – of an implied agreement among shareholders that profit dividends would only be paid if shareholders were employed by the corporation. Opinion at 10-11. While additional responsibilities “justified

some increase” in Rees’s salary, there was nothing in the record to support a finding that because minority shareholders were not employed, Rees was justified “in discontinuing the distribution of dividends and increasing his annual salary by \$700,000 to \$1million.” Opinion at 9-10. This holding is not the result of a *de novo* review by the Court of Appeals; it is the result of the Court’s review of the evidence at trial and of the trial court’s findings of fact and conclusions of law.

B. The Court of Appeals followed *Scott v. Trans-System, Inc.*

Don Rees contends that the Opinion conflicts with *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 64 P.3rd 1 (2003) by holding that Rees’ conduct constituted minority oppression, while holding in the unpublished portion that Rees’s salary increases were not excessive so as to breach his duty to the corporation or constitute fraud.

Rees’s argument ignores the Court of Appeals’ careful segregation of its holding. In the reported portion of the Opinion, the Court painstakingly reviews the well-established law going back over half a century to reach the conclusion that Rees’s conduct in punishing his children and son-in-law by ceasing to make any dividend distributions constitutes minority oppression. This determination has nothing to do with whether Petitioner’s salary from the corporation was excessive. It has everything to do with the fact that the company had profit, and although the

company could afford to continue its historic practice of distributing profit to all shareholders proportionate to their ownership, Petitioner elected to discontinue all payment of dividends, and to direct the profit solely to himself.

The Court of Appeals explained the question of whether Rees's redirection of all profit for his own sole benefit constitutes minority shareholder oppression is a different issue than that discussed in the unpublished portion of the opinion. Opinion at 17. If the determination in the unpublished portion that Rees's salary did not breach a duty to the corporation was intended to apply to the issue of minority oppression, the Court would have published that portion as well.

Rees wants to focus solely on whether his salary is excessive, ignoring the "recognized principle that majority shareholders 'must, at all times, exercise good faith toward the minority stockholders.'" Opinion at 6 (quoting *Hay v. Big Bend Land Co.*, 32 Wn.2d 887, 897, 204 P.2d 488 (1949)). But the issue with respect to minority oppression is not whether the corporation could afford Rees's dramatic increase to his own compensation, but whether "those in control of the corporation have acted . . . in a manner that is illegal, oppressive, or fraudulent." Opinion at 7 (citing RCW 23B.14.300(2))9b)).

In analyzing this issue, the Court of Appeals applied the standards set forth in *Scott*, which held that oppressive conduct includes:

the plundering of a ‘close’ corporation by the siphoning off of profits by excessive salaries or bonus payments and the operation of the business for the sole benefit of the majority of the stockholders, to the detriment of the minority stockholders.

Opinion at 7-8 (citing *Scott*, 148 Wn.2d at 713 (quoting *Baker v. Commercial Body-Builders, Inc.*, 264 Or. 614, 629, 507 P.2d 387 (1973))).

Rees ignores the basis of the oppression claim -- that he was siphoning off profits for his sole benefit, to the detriment of minority shareholders. Rees paid the profit to himself “rather than making regular dividend distributions that would benefit all the shareholders.” Opinion at 6, 9. Again, the issue is not merely the increase in his own salary and bonuses, but his act of converting the other shareholders’ proportionate share of the profits for his own exclusive benefit.

The Court of Appeals also followed *Scott* in holding that the burden does not shift to those in control to show a legitimate business justification for their decisions unless a minority shareholder has shown oppressive conduct. Opinion at 8 (“The minority shareholder bears the burden to prove oppressive conduct by a preponderance of the evidence.”) As the *Scott* court explained, it is only then that the burden shifts:

Once overreaching conduct has been demonstrated, the burden shifts to the majority shareholder or shareholders to show that there were legitimate business justifications for the conduct.

Scott, 148 Wn.2d at 709. Consistent with the decision in *Scott*, only after finding overreaching conduct by Rees did the Court of Appeals turn its attention to Rees's stated reason for his actions.

Rees admitted "... the only reason he discontinued paying dividends was because the Appellants no longer worked for RCDC." Opinion at 12. The Court of Appeals found that "nothing in the record supports a finding that because the Appellants no longer were working at RCDC, Rees was justified in discontinuing the distribution of dividends and increasing his annual salary by \$700,000 to \$1 million." Opinion at 10. Furthermore, the Court found "... no evidence that supported the finding that there was an implied agreement to distribute dividends to Appellants only while they were working for RCDC." Opinion at 11. Thus, "the undisputed evidence establishes as a matter of law that Rees's justification for paying RCDC's profits to himself instead of paying dividends – because the Appellants no longer worked for RCDC – was not a legitimate business reason." Opinion at 12.

As the Court of Appeals states,

Rees did not explain why there was a *business* reason for not paying dividends and how his dividend decision benefitted

RCDC. Instead, he admitted that the only reason he discontinued paying dividends was because the Appellants no longer worked for RCDC. He was using the payment of dividends to reward the Appellants while they worked for RCDC and to not reward them when they did not.”

Opinion at 12. The Court noted that “dividends are not ‘bonuses’ to be distributed for good performance. They are a way that the existing shareholders share in a company’s profits.” Opinion at 12. Rees had no business reason to stop paying dividends and to divert all profit to himself.

Petitioner argues that the Court’s statement in the unpublished portion of its Opinion, that Rees’s post-2014 salaries were not excessive with respect to the question of whether Rees breached his fiduciary duties to the corporation or committed fraud, necessarily means that Rees’s conduct could not be oppressive as to minority shareholders. However, as noted above, the Court distinguished the claim of minority shareholder oppression from the issues of whether Rees breached his duties to the corporation itself, and whether his actions were fraudulent. Opinion at 17.

With respect to minority shareholder oppression, the Court noted the “well-established principle that majority shareholders owe a duty of good faith to minority shareholders,” and held that a majority shareholder cannot simply stop paying dividends without a valid business justification. Opinion at 13 (citing *Hay v. Big Bend Land Co.*, 32 Wn.2d 887, 204 P.2d 488 (1949)).

C. **The Opinion does not involve a novel question of substantial public interest as it is based entirely upon well-settled law.**

The Petitioner mischaracterizes the Opinion as standing for the proposition that any time a corporation declines to declare a dividend it will constitute oppressive conduct to minority shareholders as a matter of law. Pet. Rev. at 17. That is not what the Opinion states. Rather, the Opinion carefully explains the reasoning for finding minority shareholder oppression under the egregious facts of this case. Unlike situations where majority shareholders determine it is not in the best interests of a corporation or its shareholders to declare a dividend, in this case Rees not only made the decision to pay no profit dividends for personal reasons, but he assured this draconian measure would affect all of the shareholders except himself.

Rees argues that that the Court of Appeals decision is “a shockingly profound holding, with far reaching implications for every Washington corporation with one or more minority shareholders.” Pet. Rev. at 17. He makes this claim by blatantly ignoring the test applied by Washington courts, and by the Court of Appeals in this case. The minority shareholders were required to prove that (1) Rees engaged in oppressive conduct, *and* (2) there was no legitimate business justification for the conduct. Opinion at 8 (citing *Scott*, 148 Wn.2d at 712-13). Rees simply ignores the first requirement, and misapplies the second.

In reaching its conclusion, the Court of Appeals reviewed almost the entire body of law in this state dealing with what constitutes minority shareholder oppression. In support of its decision, the Court considered RCW 23B.14.300(2)(b), which it cited as “The foundation of a minority shareholder oppression claim....” (Opinion at 7.) The Court then examined *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 708-09, 64 P.3rd 1 (2003); *McCormick v. Dunn & Black, P.S.*, 140 Wn. App. 873, 889, 167 P.3rd 610 (2007); *In Re Spokane Concrete Prods., Inc.*, 126 Wn.2d 269, 279, 892 P.2d 98 (1995); *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wn. App. 502, 509, 728 P.2d 597 (1986). Opinion at 8. The Court then concludes that “... Rees is incorrect that a majority shareholder simply can stop paying dividends without a valid business justification.” Opinion at 13. (citing *Hay*, 32 Wn.2d at 897). This decision is consistent with Washington law, and does not give rise to implications for a corporation’s shareholders outside those with facts showing that controlling shareholders’ conduct is illegal, fraudulent, or oppressive.

V. CONCLUSION

Rees fails to establish the criteria for granting a Petition for Review because the Court of Appeals applied the correct standard of review when it held that substantial evidence does not support the trial court’s findings of fact with respect to the minority oppression claim. The linchpin of the

Petitioner's argument is that portions of the unpublished opinion are to be applied to the published portion of the opinion. The fact that the Court of Appeals found in the unpublished portion of its Opinion that Rees's salary was not so excessive as to give rise to a breach of fiduciary duty to the corporation or fraud has no bearing whatsoever upon its determination that Rees's conduct in paying profits exclusively to himself, on the grounds that the minority shareholders had ceased working for the corporation, constitutes oppression of such minority shareholders.

The Court of Appeals opinion is consistent with the well-established law of this state going back over half a century. It does not give rise to an issue of substantial public importance which would merit review by the Supreme Court.

RESPECTFULLY SUBMITTED this 8th day of July, 2021.

VANDEBERG JOHNSON &
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By /s/ James A. Krueger
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CERTIFICATE OF SERVICE

The undersigned certifies under the penalty of perjury under the laws of the State of Washington that I am now and at all times herein mentioned, a citizen of the United States, a resident of the State of Washington, over the age of eighteen years, not a party to or interested in the above-entitled action, and competent to be a witness herein.

On the date given below I caused to be served the foregoing to the following individuals in the manner indicated:

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DATED this 8th day of July, 2021 at Tacoma, Washington.

/s/ Rose M Jennison
Rose M. Jennison

VANDEBERG JOHNSON & GANDARA

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