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No. 71050-8-I

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION I

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STATE OF WASHINGTON
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MARK PHILLIPS, KENNETH GORDON,
JANE DOE GORDON, and the marital community
composed thereof; DOUG LOWER AND MAUREEN LOWER,
husband and wife and the marital community composed thereof;
A DOT Corporation, a Washington corporation,

Appellants

vs.

ROBERT ARNOLD, a single man,
on behalf of BANANA CORPORATION,
a Washington corporation, assignee,

Respondent

Appeal From The Superior Court For King County
Hon. John Erlick

BRIEF OF APPELLANT

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INTRODUCTION

Appellants, Mark Phillips and ADOT, hereby appeal the ruling of Honorable Judge Washington in granting summary judgment against the defendants although there were clear, numerous triable issues of fact; and appeal the findings of facts and damages award of Honorable John Erlick, which findings and damages were unsupported by substantial evidence at trial and relied upon unqualified lay opinions. Additionally, appellants were irreparably harmed by the trial court's failure to mandate the appearance of the plaintiff, Mr. Arnold, at trial, or to impose a remedial sanction due to the failure to record the testimony of Mr. Arnold prior to his demise. For these reasons appellants request review.

ASSIGNMENTS OF ERROR

1. The trial court erred in granting Mr. Arnold's motion for summary judgment against Mr. Phillips and ADOT because Mr. Phillips presented sufficient evidence to raise a question of material fact through the testimony of an expert witness, Dennis Mandell.
2. The trial court erred in denying the Motion to Vacate Summary Judgment against Mr. Phillips and ADOT because Mr. Phillips presented evidence of a meritorious defense and excusable

neglect based upon Mr. Phillips being incarcerated at the time the motion was filed and not learning his attorney had withdrawn until shortly prior to the hearing.

3. The trial court erred in failing to order Mr. Arnold, who passed away during the early phases of the damages trial and whose testimony was never recorded, to personally appear at trial in violation of KCLCR 4(i) and in not imposing a remedial sanction to Mr. Phillips for his failure to appear.
4. The trial court erred in basing its award of damages upon non-qualified expert testimony and completely disregarded the only qualified and properly admitted expert testimony of Dennis Mandell and his expert report.
5. The trial court erred in finding that Banana suffered damages.
6. The trial court erred in finding that Mr. Arnold had not waived any right to recover the damages related to Mr. Lower given that Mr. Arnold had entered into a settlement agreement with Mr. Lower.
7. The trial court erred in calculating damages to include money that was allegedly spent by Mr. Phillips, but, in fact, had never been “money” that was in Banana’s accounts.

STATEMENT OF THE CASE

Appellant, Mark Phillips, is a talented computer programmer and designer as well as an entrepreneur. Mr. Phillips was the founder of Banana Corporation and of ADOT Corporation, and was the sole shareholder in the corporations and the chief operating officer.¹ Banana was incorporated for the purpose of developing and commercializing a mobile payment system using cellular telephones, “MettaWallet,” the technology of which was targeted to third-world countries that lacked a coherent banking infrastructure but had wide cellular service.² ADOT was set up by Mr. Phillips to be his “technology incubator” which would develop and refine various technologies. ADOT entered into a service contract with Banana that defined the work ADOT was to perform for Banana³ and also entered into contracts and service agreements with other companies, such as Microsoft.⁴ Mr. Phillips sought investment dollars for Banana to develop the MettaWallet technology from Robert Arnold, a Seattle based philanthropist who agreed to invest \$5.5 million in return for stock in Banana. Mr. Arnold and Mr. Phillips were the only shareholders of Banana.⁵

¹ RP 2-26-13, 7:15-24; 14:7-19

² RP 2-26-13, 17:13 to18:18

³ Ex 207

⁴ Ex 249; RP 2-26-13 21:13 to 22:6

⁵ RP 2-26-13, 38:10-23

There is no dispute that in entering into the Subscription Agreement⁶ Mr. Arnold was fully aware of all of Mr. Phillips' various business interests and the interplay between his corporations. Mr. Arnold granted Mr. Phillips broad powers and discretion in the management and operations of Banana. The crux of the dispute between the parties is whether Mr. Phillips' disclosed to Mr. Arnold all material facts regarding the business activities of Banana, and whether Mr. Phillips' use of the investment funds in Banana had a legitimate business purpose. Mr. Arnold alleges that Banana had no mature business expectations or relationship, no revenues, and had abandoned pursuit of its purported purpose in the MettaWallet technology. Mr. Arnold further alleges that Mr. Phillips did not make any required disclosures to Mr. Arnold. Mr. Phillips contends that Banana was properly run and managed, that it did enter into at least one contract with a mobile provider in Bolivia,⁷ that it actively sought business with other companies in other countries, and that each and every expense of the funds invested in Banana was for a proper and legitimate purpose. Mr. Phillips asserts that he regularly updated Mr. Arnold on all developments of Banana,⁸ that on many such occasions Mr. Arnold's personal assistant, Maureen Lower, was present or within

⁶ Ex 208; RP 2-26-13, 53:22 to 54:13

⁷ RP 2-26-13, 36:12-22

⁸ RP 2-26-13, 46:1-6

hearing, and that Mr. Arnold had consented to the degree of latitude permitted Mr. Phillips in the use of those funds given the disclosures and warranties contained in the Banana Stock Subscription Agreement.⁹

Robert Arnold, on behalf of Banana Corporation, filed a complaint for damages for breach of fiduciary duty, unjust enrichment, and breach of contract alleging personal causes of action as well as derivative claims against Mr. Phillips, MOD Systems, Inc., Doug Lower, Maureen Lower, and Banana Corporation. On November 6, 2009, Judge Erlick dismissed the derivative claims against Banana Corporation for Mr. Arnold's lack of standing. Mr. Arnold subsequently filed an amended complaint against Banana Corporation, ADOT Corporation, Mark Phillips, Doug Lower, Maureen Lower, and Kenneth Gordon. On March 14, 2010, Mr. Arnold settled with Banana Corporation and assigned all rights it may have against Mr. Phillips, the Lowers, and ADOT to Arnold. Subsequently, Mr. Arnold settled with the Lowers.

Having been assigned the claims from Banana, Mr. Arnold moved for summary adjudication against Mr. Phillips and ADOT on or about April 18, 2012. At the time, Mr. Phillips was incarcerated in federal prison in Oregon. When Mr. Phillips entered prison, he and ADOT were represented by retained counsel, John Du Wors. In January 2012, Mr. Du

⁹ RP 2-20-13, 145:5-21

Wors withdrew as counsel of record, but failed to properly serve Mr. Phillips with the Notice of Withdrawal.¹⁰ In May 2012, Mr. Phillips was served with Mr. Arnold's Motion for Summary Judgment as well as the withdrawal of his attorney. Having few resources, Mr. Phillips filed a declaration in opposition to the motion which included a financial report prepared by an expert retained by Mr. Phillips, Dennis Mandell of Mako Strategies.¹¹ The Mako Report rebutted each and every allegation of Mr. Arnold. Despite the report, Judge Washington granted the motion for summary judgment on July 20, 2012 against Mr. Phillips and ADOT.

The basis for the causes of action concerned the following transactions: Mr. Phillips authorized a loan of \$220,000 from Banana to Mr. Lower and Banana paid him a consulting fee of \$450,000 (the parties dispute whether this was a finder's fee, which would require disclosure to Mr. Arnold, or a consulting fee, which would not); Banana loaned ADOT \$2,385,000 of which \$50,000 was repaid; Banana paid ADOT a \$1 million dollar consulting fee; Banana gave Mr. Phillips a \$50,000 loan and paid him a \$1,160,000 consulting fee; from the funds received by ADOT, it paid Mr. Phillips a total of \$1,675,000 and made two income tax payments on behalf of Mr. Phillips totaling \$705,000; ADOT made a series of wire transfers in amounts ranging from \$1,000 to \$150,000 to

¹⁰ CP 86

¹¹ Ex 228

foreign accounts; and that Mr. Phillips did not have any meaningful form of corporate governance for either company and engaged in self-dealing because many of the above-listed transactions occurred while Mr. Phillips was the majority shareholder of each party to the transaction. A preliminary accounting report was prepared by Guido van Drunen of KPMG which suggested, with reservations, that corporate waste had occurred. When plaintiff's counsel improperly attempted to convince the court that Mr. van Drunen was "an expert," Mr. van Drunen corrected him, testifying that he was a "fact witness" only.¹² Although the report, which claims to be "preliminary," was not admitted at trial, the court did indicate that it could "consider the KPMG report" for "foundational purposes" in analyzing the testimony of Mr. van Drunen and Mr. Mandell.¹³

Appellants contend that the KPMG report was not properly admitted at trial and should not have been considered by the court because it was prepared by a fact-witness, was admittedly incomplete and only a preliminary report, was based upon hearsay, and prepared without even interviewing Mr. Arnold. In response, Mr. Phillips engaged Dennis Mandell of Mako Strategies to do an expert forensic accounting report of Banana and ADOT. Mr. Mandell's investigation was exhaustive and

¹² RP 2-19-13, 79:15-20

¹³ RP 7-31-13, 10:23 to 11:15

comprehensive, and reached vastly different conclusions.¹⁴ It found that all of the expenses had a business justification, and that each loan and every payment to Mr. Lower, Mr. Phillips, and ADOT was for a legitimate purpose. The report also concluded that all of Mr. Phillips' conflicts of interest were disclosed and agreed to by Mr. Arnold and that there was no self-dealing.¹⁵

The matter came to trial for the sole purpose of determining the amount of damages suffered by Banana. Despite the finding of liability on summary judgment, Mr. Phillips argued that the Mako Report establishes that Banana suffered no damages because its business expenses were related to legitimate business purposes and not causally related to the actions for which Mr. Phillips was found liable.

At trial, Mr. Arnold failed to appear. On February 5, 2013, Mr. Phillips and ADOT moved under KCLCR 4(i) to dismiss on the basis that Mr. Arnold would not be attending trial. The court ruled that Mr. Arnold must attend trial without a request for an excuse. On February 6, 2013, the court considered Mr. Arnold's excuse and found that he was a critical and key witness. The court reasoned:

Obviously, I do not think that requiring an 84-year-old gentleman, who was two weeks post-cardiac surgery, to fly to Seattle, is an appropriate remedy, nor do I believe that dismissal of this case,

¹⁴ RP 2-21-13, 54:15 to 55:12

¹⁵ RP 2-21-13, 96:3-14

due to extraordinary circumstances, is an appropriate remedy. It is my opinion that Mr. Arnold's testimony *must* be obtained (emphasis added).¹⁶

The court ordered that Mr. Arnold's testimony be recorded and ordered the parties to confer regarding taking his deposition.¹⁷ The court then reversed itself due to Mr. Arnold's poor health and reserved ruling with regard to his testimony pending Mr. Phillips and ADOT's presentation of evidence. Mr. Arnold passed away on February 27, 2014 prior to the Court making a final ruling on his testimony.

The subsequent trial proceeded without testimony from Mr. Arnold. The Trial Court entered findings of fact that supported the tentative opinions contained in the KMPG report. The court awarded damages for breach of fiduciary duty and unjust enrichment in the amount of \$4,190,000 and made Mr. Phillips personally responsible. The court found ADOT in breach of its promissory note to Banana in the amount of \$2,335,000, and awarded Banana an additional \$760,709.58 in interest. Banana had not generated any income and had received only the Arnold investment of \$5.5 million, yet the combined damages determined by the court exceed the total amount of money obtained by Banana, meaning the court awarded Banana damages to Banana for money that did not come from the Banana accounts.

¹⁶ RP 11:23 to 12:4

¹⁷ RP 12:7 to 15:16

ARGUMENT

1. The Court Erred In Granting Mr. Arnold's Motion For Summary Judgment Against Mr. Phillips And ADOT.

a. Standard Of Review.

A court of appeal reviews summary judgment orders de novo, performing the same inquiry as the trial court. *Kruse v. Hemp*, 121 Wash.2d 715, 722, 853 P.2d 1373 (1993). In reviewing a grant of summary judgment, the appellate court engages in the same inquiry as the trial court. *Marincovich v. Tarabochia*, 114 Wn.2d 271, 274, 787 P.2d 562 (1990). Even if a trial court enters findings of fact, because summary judgment motions are reviewed de novo, these findings are superfluous and need not be considered. *Duckworth v. City of Bonney Lake*, 91 Wash.2d 19, 21-22, 586 P.2d 860 (1978). In conducting this inquiry, the court of appeal must view all facts and reasonable inferences in the light most favorable to the nonmoving party. *City of Lakewood v. Pierce County*, 144 Wash.2d 118, 125, 30 P.3d 446 (2001). Summary judgment is proper only where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. CR 56(c); *Korlund v. Dyn Corp Tri-Cities Servs.*, 156 Wn.2d 168, 177, 125 P.3d 119 (2005). Summary judgment should be granted if reasonable persons could reach but one conclusion from the evidence presented. *Id.* “A

material fact is one upon which the outcome of the litigation depends, in whole or in part.” *Barrie v. Hosts of Am., Inc.*, 94 Wash.2d 640, 642, 618 P.2d 96 (1980). Washington law “favors determination of controversies on their merits...” *Griggs v. Averbek Realty, Inc.*, 92 Wn.2d 576, 599 P.2d 1289 (1979).

b. The Court Erred In Granting Partial Summary Judgment Against Mr. Phillips.

Mr. Phillips was incarcerated in a federal penitentiary at the time of the summary judgment hearing. Mr. Phillips’ access to legal assistance was significantly limited. More importantly, as a result of service error, Mr. Phillips was under the mistaken belief that he was represented by counsel through May 2012.¹⁸ In fact, counsel had attempted to withdraw in January 11, 2012 and had done nothing in the matter since that date. Again, as a result of the service error on the part of counsel, Mr. Phillips did not receive the Notice of Intent to Withdraw. However, it was not until the end of May 2012 that Mr. Phillips learned that his counsel had withdrawn. As a result of his incarceration and limited access to funds, Mr. Phillips proceeded pro se.

In opposition to the partial summary judgment, Mr. Phillips provided the court with a declaration¹⁹ and a report prepared by Mako

¹⁸ CP 86

¹⁹ CP 87, 88, 89, 106, 107

Strategies.²⁰ This report was prepared by an expert who had been retained by Mr. Phillips during the preparation of his defense in this matter. According to the Order Granting Partial Summary Judgment of August 21, 2012,²² the Court considered the Mako Report. Taken at its face value, the Mako Report addressed each and every contention raised by Mr. Arnold against Mr. Phillips for claims of Corporate Waste and Looting; Conversion; Breach of Fiduciary Duty; and Unjust Enrichment; and against ADOT for claims of Breach of Contract and Unjust Enrichment. The Mako Report contradicted each and every material fact asserted in Mr. Arnold's motion as being "without substantial controversy." Conflicting opinions that reach contrary conclusions from the facts preclude summary judgment and require the court to construe the conflicting evidence in the favor of the non-moving party. *Young v. Key Pharmaceuticals, Inc.*, 112 Wn.2d 216, 239 (1989). The Mako Report, which was reviewed and considered by the Court, was sufficient to overcome Mr. Arnold's Summary Judgment motion as it directly contradicts all of Plaintiff's claims and thus creates issues of material fact.

The court erred in finding no material issue of fact with respect to a number of issues, about which reasonable minds would differ, regarding

²⁰ Ex 228, CP 87; CP 58. The report relied upon by plaintiff in the motion for partial summary judgment, prepared by KPMG, was ruled inadmissible during the subsequent damages trial.

²² CP 106, 107.

the issue of liability. The trial court relied upon the fact that liability was determined against Mr. Phillips in its Findings of Fact and Conclusions of Law.²³ In pertinent part, the Mako Report rebutted every issue of material fact raised in Mr. Arnold's Summary Judgment Motion: a) that ADOT had no discernible business relationship with Banana;²⁴ b) that Banana was not an established company;²⁵ c) that the \$200,000 loan to Mr. Lower had no business justification; d) that the \$450,000 consulting fee to Mr. Lower was a finder's fee; and e) that ADOT received \$2,385,000 in loans with no business justification and had no business relationship with Banana.

The Mako Report states that there was no embezzlement and that all funds were accounted for in MetaWallet books.²⁶ In part, it found disclosures of conflicts of interest, that record keeping for consulting fees was not required because it was for creative services, that Mr. Lower's fee was not a finder's fee, and that the ADOT and Mr. Lower loans had business purposes. It noted that Mr. Phillips worked to secure business through Millicom and NuevaTel, had provided Mr. Arnold and his investment consultant with updates, and that prior to the Series A financing of MOD, the firm of Lasher and DLA Piper reviewed MetaWallet materials without any findings of fraud or embezzlement.

²³ CP 240

²⁴ CP 58, Arnold's Summary Judgment p. 4

²⁵ CP 58 p. 3.

²⁶ Ex 228

Given that the court was required to consider all evidence and reasonable inferences in favor of the nonmoving party, the Mako Report alone was sufficient to defeat the Motion for Summary Judgment. In granting plaintiff's Motion for Partial Summary Judgment against Mr. Phillips and ADOT, the court committed reversible error. This Court, in its review of the trial court's Summary Judgment Order made an error finding of liability was manifestly a part of Judge Erlick's ruling in awarding damages to Mr. Arnold.

c. The Court Erred In Granting Summary Judgment Against ADOT Even Though It Was Not Represented By An Attorney.

In granting Mr. Arnold's Summary Judgment Motion against ADOT, the Court relied upon the technicality that ADOT, a corporation, was not represented by counsel. Mr. Phillips attempted to appear on behalf of ADOT, but could not because he was not a licensed attorney. The default judgment entered against ADOT as a result of its failure to appear is an injustice to ADOT because ADOT can clearly demonstrate a meritorious defense and the default came about through excusable neglect beyond the control of ADOT. Mr. Phillips was the sole shareholder of ADOT and at the time of the motion for summary judgment was in federal prison. Prior to being incarcerated Mr. Phillips had retained counsel to represent ADOT, which counsel withdrew from representing ADOT

without prior notice to Mr. Phillips and while the motion for summary judgment was pending.

On January 2, 2013, after Mr. Phillips had been released from detention and was able to retain counsel, he filed a motion to vacate the finding of liability and ADOT's finding of liability by the trial court on August 22, 2012. CR 60(b)(1) provides that an order or judgment may be vacated in the event a judgment or order is obtained through mistakes, inadvertence, surprise, excusable neglect or irregularity.²⁷

"Interpretation of a court rule is a question of law, subject to de novo review." *Gourley v. Gourley*, 158 Wn.2d 460, 466, 145 P.3d 1185 (2006). A trial court's decision on a motion to vacate under CR 60(b) is reviewed for abuse of discretion. *Haller v. Wallis*, 89 Wn.2d 539, 543, 573 P.2d 1302 (1978). "An abuse of discretion is present only if there is a clear showing that the exercise of discretion was manifestly unreasonable, based on untenable grounds, or based on untenable reasons." *Moreman v. Butcher*, 126 Wn.2d 36, 40, 891 P.2d 725 (1995). "A decision is based 'on untenable grounds' or made 'for untenable reasons' if it rests on facts unsupported in the record or was reached by applying the wrong legal standard." *State v. Rohrich*, 149 Wn.2d 647, 654, 71 P.3d 638 (2003) (quoting *State v. Rundquist*, 79 Wn. App. 786, 793, 905 P.2d 922 (1995)).

²⁷ CP 107

“A decision is ‘manifestly unreasonable’ if the court, despite applying the correct legal standard to the supported facts, adopts a view ‘that no reasonable person would take,’ *State v. Lewis*, 115 Wn.2d 294, 298-99, 797 P.2d 1141 (1990), and arrives at a decision ‘outside the range of acceptable choices.’” *Rohrich*, 149 Wn.2d at 654 (quoting *Rundquist*, 79 Wn. App. at 793).

A proceeding to vacate a default judgment is equitable in character, in which the court should exercise its authority to ensure that substantial rights are preserved and justice done. *White v. Holm*, 73 Wn.2d 348., 438 P.2d 581 (1968). Because the court’s primary concern is that the default judgment is equitable, the trial court’s decision must be reviewed by considering the unique facts and circumstances of the case. *Showalter v. Wild Oats*, 124 Wn. App. 506, 511, 101 P.3d 867 (2004). The court is more likely to reverse a trial court decision refusing to set aside a default judgment. *Id.*

The party seeking to vacate a default judgment under CR 60 must demonstrate four factors. The primary factors are: (1) the existence of substantial evidence to support, at least prima facie, a meritorious defense; (2) the reason for the party’s failure to timely appear, i.e., whether it was the result of mistake, inadvertence, surprise or excusable neglect. The secondary factors are: (3) the party’s diligence in asking for relief

following notice of the entry of the default; and (4) the effect of vacating the judgment on the opposing party.” *Wild Oats*, 124 Wn. App. at 511. In the instance where a technical failure resulted in an injustice and the moving party is able to demonstrate a meritorious defense, the Court is justified in vacating the default judgment. *White v. Holm*, 73 Wn.2d 348, 438 P.2d 581 (1968). The more conclusively such a defense can be shown, the more readily the Court will vacate the default judgment. *Merrell v. Hamilton Produce Co.*, 55 Wn.2d 684, 349 P.2d 597 (1960). For instance, in a case where an insured mistakenly believed his insurer would be entering a notice of appearance on his behalf constituted a genuine misunderstanding for purposes of vacating a default judgment. *Norton v Brown*, 99 Wn. App. 118, 124, 992 P.2d 1019 (1999).

The use of CR 60(b)(11) is also applicable to situations involving circumstances not covered by any other section of this rule. *In re Marriage of Flannagan*, 42 Wn. App. 214, 221, 709 P.2d 1247 (1985). The courts have construed extraordinary circumstances as “unusual circumstances that are not within the control of the party.” *State v. Gamble*, 168 Wn.2d 161, 169, 225 P.3d 973 (2010).

ADOT, though not represented by counsel, had provided evidence to the court of its meritorious defense through its sole corporate officer,

Mr. Phillips. Mr. Phillips, in having been incarcerated *and* believing that both he and ADOT were represented by counsel, should constitute an “extraordinary circumstance” that was not within his control. Despite this, Mr. Phillips submitted evidence to the court in the form of the Mako Report from a qualified expert that contradicted each and every basis for which the court found ADOT liable. Specifically, in the “Executive Summary” of the Mako Report, the report notes, “The ADOT and Lower loans did have a business purpose, i.e., funding ADOT’s R&D and employee retention.”²⁸ At a minimum, ADOT was able to demonstrate a meritorious defense to the Court, even though it was not represented by counsel at the time. The court committed error in not reversing Summary Judgment against ADOT because that exercise of discretion was manifestly unreasonable and based on untenable grounds. The record created by Mr. Phillips at the time of the summary judgment hearing was replete with facts in the record that support the opposite legal conclusion to find that there were material questions of fact. If this Court, in its de novo review of the grant of summary judgment against Mr. Phillips, finds sufficient facts to overturn the summary judgment finding, then this would serve as prima facie evidence that ADOT had a meritorious defense which would favor finding excusable neglect to reverse the default finding.

²⁸ Ex 228

2. The Court Erred In Failing To Order Mr. Arnold's Attendance At Trial Or Otherwise Secure His Testimony.

The court committed error in not granting Mr. Phillips' motion to dismiss the lawsuit under King County Local Rule 4(i)(1) for Mr. Arnold's failure to appear. This rule provides that "the failure of a party seeking affirmative relief or asserting an affirmative defense to appear for trial on the scheduled trial date will result in dismissal of the claims or affirmative defense without further notice." KCLCR 4(i)(1). It appears that the application of this rule to these circumstances is a case of first impression; there is no appellate treatment of the rule. The construction of the court rule is atypical in that it does not allow the court to consider prejudice, uses the word "will" as opposed to "shall," and provides no relief as a remedial sanction.

The court initially ordered Mr. Arnold to appear for trial.²⁹ The court then ruled on the following day of trial that Mr. Phillips would be allowed to secure the testimony of Mr. Arnold through deposition in light of his medical condition preventing him from appearing at trial.³⁰ The court did not find dismissal to be a proper remedy due to these "extraordinary circumstances."³¹ Mr. Arnold then died and his testimony was never taken, despite the fact that the case had been pending for three

²⁹ RP 2-5-13 15:1-4

³⁰ RP 2-6-13 12:3-4

³¹ Id.

years. The trial court permitted the trial to proceed with no remedy to Mr. Phillips for the failure to secure Mr. Arnold's testimony or appearance at trial.

A court may not disregard a party's failure to abide by rules that implicate production of testimony. CR 43(f)(1) provides that a party may be compelled to be examined at trial. CR 43(f)(3) provides sanctions, including the striking of pleadings and adverse inferences. CR 43(f)(3). CR 30 governs depositions and CR 37(b)(2)(A)(B) is its mechanism for sanctions. The court has held in the context of CR 43(f) that a trial court cannot refuse to consider a coercive sanction for a party's refusal to appear for trial. *Campbell v. A.H. Robins Co.*, 32 Wn. App. 98, 101-2 (1982). This includes the sanction of dismissal for failure to prosecute the action due to the failure of that party to appear for trial. *Alexander v. Food Services of Am.*, 76 Wn. App. 425, 429 (1994).

The trial court acknowledged the substantial injustice on Mr. Phillips in allowing the trial to proceed without Mr. Arnold but ordered no remedial action or sanction.³² The court then entered Findings of Fact ("FOF")³³ that were largely based upon its adverse credibility determinations of the only two parties, Mr. Phillips and Ms. Lower, who had contact with Mr. Arnold, and were witnesses to the representations

³² RP 2-6-13 11:9-11, 19-22

³³ CP 240

and disclosures made to him. As Mr. Phillips' counsel argued during trial, Mr. Arnold was a key witness in that he signed a subscription agreement with clear recitals of conflict of interest disclosures between Banana, ADOT and Mr. Philips. He was the real party in interest to Banana, yet never previously sought damages under the independent board of directors of Banana and failed to appear for a trial on damages.³⁴ In fact, the KMPG report was prepared without any input from Mr. Arnold, the testimony about which was admitted into trial.³⁵

Despite being a key witness and party to these proceedings, Mr. Arnold had no involvement in the case. It is not clear that Mr. Arnold reviewed or was aware of any of the other pleadings in this matter. More importantly, his testimony was never recorded under oath, despite numerous requests from Mr. Phillips and his counsel. All claims made in this case can basically be reduced to what disclosures, either written or oral, were given to Mr. Arnold. The prejudice to Mr. Phillips is obvious.

Many of the issues raised at trial involved what disclosures, if any, were made to Mr. Arnold by Mr. Phillips or others representing Banana. Mr. Phillips testified to making specific disclosures to Mr. Arnold regarding expenditures and loans made by Banana to Phillips, A DOT and

³⁴ RP 2-6-13 6:13-25

³⁵ RP 2-19-13 113:16-18

others.³⁶ Maureen Lower testified to being present during many such conversations.³⁷ In contrast, Mr. Arnold's witnesses admitted to not being present or involved during the time Mr. Arnold entered into the investments³⁸ and to not having first-hand knowledge of any of the discussions or agreements between Mr. Arnold and Mr. Phillips.³⁹

The local rules may not be applied in a manner inconsistent with the civil rules. *See Harbor Enters., Inc. v. Gudjonsson*, 116 Wn.2d 283, 293, 803 P.2d 798 (1991) (citing *State v. Chavez*, 111 Wn.2d 548, 554, 761 P.2d 607 (1988)); CR 83(a). KLCLCR 4(i)(1) imposes the most severe sanction of all, dismissal, for the non-appearing party at trial. This rule is not inconsistent with the sanction of dismissal allowed for discovery violations. CR 37(b)(2)(C). In this case, it would not be an inconsistent sanction to dismiss under KLCR 4(i)(1).

3. The Trial Court Erred In Entering Its Conclusions Of Law Based Upon Findings Of Fact Which Were Not Supported By Substantial Evidence.

Appellate review is limited to whether substantial evidence supports the FOF and in turn whether the FOF support the conclusions of law ("COL"). *Ridgeview Properties v. Starbuck*, 96 Wn.2d 716, 719, 638 P.2d 1231 (1982). Notably, the court entered its FOF without mention of

³⁶ RP 2-26-13 44-50, 56-61, 7-71, 76-78, 80-84, 89-90, 101-103, 118-119, 136-139

³⁷ RP 2-26-13 121-128

³⁸ RP 2-19-13 13:13-15

³⁹ RP 2-19-13 17:19-16

the testimony from the one expert witness in this case, Mr. Mandell. Courts in Washington have long held that a qualified expert is competent to express an opinion on a proper subject even though he expresses an opinion on the ultimate fact to be found by the trier of fact and that courts should consider an expert's opinion in making its decisions. "There are many matters, however, about which the triers of fact may have a general knowledge, but the testimony of experts would still aid in their understanding of the issues." *Gerberg v. Crosby*, 52 Wn.2d 792,795-796,329 P.2d 184 (1958). In short, Mr. Mandell contradicted all of the findings entered by the court that were based upon non-expert testimony.

a. The Court Relied Upon Inadmissible Hearsay In Its FOF.

During trial, the Court made two specific rulings with respect to the KMPG report:

To the extent Mr. Van Drunen's report is hearsay... the court will not admit it substantively. To the extent that it is needed for foundational purposes, as a part of the Mako Report... I think the court has to admit it, not necessarily for substantive purposes, but to bolster, if you will, Mr. Mandell's expert testimony criticizing the conclusions of Mr. Van Drunen. It goes without saying, now that the Mandell report is admitted, that as far as proof of the matter asserted, the court will consider Mr. Van Drunen's testimony and reviews his report strictly for illustrative purposes, to support his testimony and as referenced in Exhibit 228.⁴⁰

⁴⁰ RP 7-31-13 10:23 to 11:15

...to the extent that the report relies upon otherwise inadmissible hearsay, the court should, either, not consider, or give it or give it whatever weight it is due. As I indicated, I thought large portions of the report could be considered by the court, specifically those portions that were admissions of parties opponent, those parts of the report that relied upon the business records exception, and those parts of the report that were summaries under 1006.⁴¹

A trial court's decision to admit or exclude evidence lies within its sound discretion. It will not overturn evidentiary rulings unless the trial court has manifestly abused its discretion. *State v. Bourgeois*, 133 Wash.2d 389, 399, 945 P.2d 1120 (1997). It is a basic rule of evidence that a nonexpert witness, when testifying, must state facts and not his opinion or conclusion. *Ulve v. City of Raymond*, 51 Wn.2d 241, 317 P. 2d 908 (1957). Any opinion would necessarily invade the province of the jury, because the nonexpert is no better qualified than are the jurors to reach a conclusion. *Knight v. Borgan*, 52 Wn.2d 219 (1958).

First, the court stated that the basis for admitting the KMPG report was to "bolster Mr. Mandells' opinions" and consider it for foundational purposes in how the Mako Report criticized its conclusions. In addition, the court clarified it would only consider those portions of the report that were admissions of a party opponent and those which relied upon the business records exception and consider the remaining portions of the

⁴¹ RP 2-21-13 66:6-15

report for illustrative purposes only. However, the court relied upon the opinions and conclusions of Mr. van Drunen in his analysis of the KMPG report, not merely upon Mr. van Drunen's recitation of facts alone as it related to laying the foundation as the set of facts upon which the Mako report's conclusions were based. Mr. van Drunen identified himself as a fact witness and not an expert.⁴² The court committed error in far exceeding the scope of the basis for which it admitted the KMPG report by considering the conclusions in the KMPG report as substantive evidence, to prove the truth of the matters asserted. As discussed below, the testimony of Mr. van Drunen of the "facts" were, in fact, lay opinion conclusions as to what those facts represented. In the trial court's findings of fact, it, indeed, adopted every conclusion of the KMPG report as its own. The court did not make findings with respect to how this report served to "bolster" the Mako Report or how the foundation laid by those facts supported the court in making findings that were contrary to the conclusions of the Mako Report. The court simply disregarded the Mako Report in its entirety and adopted the conclusions of the KMPG Report.

Second, there was no evidence that the Mako Report was prepared as a critique of the KMPG report. Rather, its stated purpose was to assist Mr. Phillips with litigation. Concerned with the findings of the KPMG

⁴² RP 2-19-13 79:19-20

report, the failure of Mr. van Drunen to interview Mr. Arnold and other key witnesses, and Mr. van Drunen's limited resources to review all appropriate records, the Mako Report was commissioned to provide an independent expert evaluation of the subjects raised in the KMPG report. The audit performed was far more extensive and resulted in an expert opinion that no "corporate looting" or other financial irregularity had occurred with Banana and ADOT.

Third, FOF #22 states "(a)ccording to the testimony of Mr. van Drunen," the disbursements, consulting fees and loans were not disclosed to or approved by Mr. Arnold. It would be impossible for Mr. van Drunen to determine what had been disclosed or approved by looking exclusively to the admissible evidence. Mr. van Drunen relied on inadmissible hearsay to reach his conclusion. Specifically, Mr. van Drunen relied on interviews with key personnel, which would be hearsay under ER 801 and 802.

Fourth, the KPMG report, upon which Mr. van Drunen based his testimony, contained many deficiencies and unsupported conclusions:

1. The KMPG report was prepared as a "preliminary report" intended only for the use of Banana and its counsel and not for "any other purpose."⁴³
2. Mr. van Drunen had not reviewed all of the corporate records.⁴⁴

⁴³ RP 2-19-13 112:13-24

⁴⁴ RP 2-19-13 138:6 to 139:6-19

3. Mr. van Drunen did not interview all of the witnesses, including Mr. Arnold.⁴⁵
4. Many of the documents reviewed by Mr. van Drunen could not be identified by Banana's CFO, Mr. Gordon.⁴⁶
5. Mr. van Drunen could not take a position as to whether ADOT had actually provided the services in the service agreement with Banana.⁴⁷
6. Mr. van Drunen expressed an opinion that ADOT return the consulting fees paid to Mr. Phillips.⁴⁸
7. Mr. van Drunen admitted to not tracing all the assets from Banana.⁴⁹
8. Mr. van Drunen stated he did not fully understand the basis for the payments of money from ADOT to Mr. Phillips, but nonetheless stated they were conflicted transactions.⁵⁰
9. Mr. van Drunen admitted to not tracing the foreign wires from cradle to grave.⁵¹
10. Mr. van Drunen was unaware the MOD had received 25 million.⁵²
11. Mr. van Drunen had a lack of documentation to do an independent IP valuation.⁵³
12. Mr. van Drunen admitted the board of directors would need to consider the IP's value to determine if the payments to Mr. Phillips were proper.⁵⁴ (which the Mako Report did take into account)

⁴⁵ RP 2-19-13 131:9-25; 139:20 to 140:17; 148:5-24

⁴⁶ RP 2-19-13 133:21; 137:15; 139:19; 153:2

⁴⁷ RP 2-20-13 22:3-16

⁴⁸ RP 2-20-13 23:9-14

⁴⁹ RP 2-20-13 24: 1-21; 30:1 to 32:17

⁵⁰ RP 2-20-13 26 3 to 27:25; RP 2-19-13 75:1 to 76:19

⁵¹ RP 2-20-13 31: 8-14

⁵² RP 2-20-13 33: 8-24

⁵³ RP 2-20-13 35: 7-17, 38: 9-25; RP 2-19-13 141: 1-21

⁵⁴ RP 2-20-13 39:9 to 40:6

13. Mr. van Drunen stated an opinion that the nonexclusive IP license agreement with Banana was illusory.⁵⁵
14. Mr. van Drunen admitted to not forensically imaging either the Banana or ADOT computers.⁵⁶
15. Mr. van Drunen did not do independent audit.⁵⁷

Tellingly, the trial court failed to refer to the Mako Report at all in its Findings of Fact, a shocking dismissal of the only competent expert testimony admitted at the trial. Mr. Mandell's expert opinions on the ultimate issues that Mr. Phillips did not commit corporate waste or embezzlement, and that each expenditure had a legitimate business purpose, should have been dispositive of this issue and adopted by the court. However, in disregarding the Mako Report, the trial court relied upon the "lay" opinion of a "fact" witness over an expert witness.

Within this context, the following Findings of Fact were not supported by substantial evidence.

b. The Trial Court Erred In FOF 16 In Finding That The Testimony Of Mr. Van Drunen Supported That A \$1 Million Dollar Payment Was A Consulting Fee And Not A Licensing fee.

The trial court held that "Phillips has claimed that the \$1,000,000 'consulting fee' payment from Banana to ADOT was actually for 'license

⁵⁵ RP 2-19-13 105:24 to 106:11

⁵⁶ RP 2-19-13 138: 1-21

⁵⁷ RP 2-19-13 142-143: 7-21

fees,' and not pursuant to the Service Agreement but at the time of the payment of the consulting fee, the intellectual property allegedly licensed had already been assigned by Phillips to Banana in return for stock.”⁵⁸ This finding is not supported by substantial evidence and misconstrues the record. All evidence from all parties, including from Mr. Phillips,⁵⁹ the tentative opinions found in the KMPG report,⁶⁰ and the expert opinions from the Mako Report⁶¹ supported the same conclusion – that the payment to Mr. Philips was for “consulting fees.”

4. The Trial Court Erred In FOF 17 In Finding That The \$1 Million Dollar Payment From Banana To ADOT Was Without Any Legitimate Business Justification.

On June 1, 2005, ADOT Corporation and POP Media Corporation (the predecessor company to MOD Systems) executed a Intercompany Agreement which provided that MOD would provide many services, including, but not limited to, office space, general administration, development services, general corporate services, insurance, and employee benefits.⁶² On July 1, 2005, ADOT and Banana executed a Service Agreement for a number of services, including, but not limited to, development services, general corporate services, and other services to be

⁵⁸ CP 240 5:15

⁵⁹ RP 7-29-13 15:5-8

⁶⁰ RP 2-6-13 44,152; RP 2-19-13 71

⁶¹ RP 2-25-13 5:16 to 6:8

⁶² Ex 249

determined.⁶³ Following the execution of the Service Agreement, ADOT, through the Service Agreement, and MOD, through the Intercompany Agreement, began to provide services related to the Banana/MetaWallet intellectual property. From July 1, 2006, the date of the Service Agreement, through December 13, 2006, the date of payment of the ADOT consulting fee, ADOT incurred the following costs associated with the work done for Banana: \$40,950 for prototyping; \$178,297.50 for hardware engineering; \$44,523.75 for hardware; \$9,694.00 for contract employees; \$98,863.50 for contract engineering; \$89,355.00 for hardware engineering; \$14,309.00 for professional fees; and \$20,700.00 for consulting, totaling 496,707.70.⁶⁴

It is undisputed that ADOT was performing work for Banana under the Service Agreement for which it was paid \$1 million almost concurrently with the execution of the NeuvaTel contract. Importantly, again, Mr. Arnold was made aware of the NuevaTel contract and the consulting fee paid to ADOT.⁶⁵

5. The Trial Court Erred In FOF 18 - 25 In Finding That The \$2,385,000 Loan From Banana To ADOT, Subsequent Transfers Of Money From ADOT To Mr. Phillips, And \$1,160,000 Consulting Fee From Banana To Mr. Phillips Was Without Business Justification, Constituted Self-

⁶³ Ex 207

⁶⁴ Ex 107

⁶⁵ Id.

Dealing And Breach Of Fiduciary Duty, And Were Not Disclosed To Mr. Arnold.

Substantial evidence does not support the trial court's finding that the transfers of money from Banana to ADOT were without business justification. ADOT did a significant amount of business prior to and following Mr. Arnold's investment in Banana. Mr. Arnold first subscribed to Banana on July 7, 2006,⁶⁶ however, the first check he wrote to Banana was dated June 22, 2006.⁶⁷ A Promissory Note ("ADOT Promissory Note") was executed between ADOT and Banana on September 1, 2006⁶⁸ and the first draw on the ADOT Promissory Note in the amount of \$100,000.00 was taken the same day.⁶⁹ A review of the 2006 ADOT General Ledger indicates that ADOT had \$50,159.62 in its WaMu Business Money Market Account, \$7,252.39 in its WaMu Checking Account, and had invoiced its customers a total of \$465,537.85 prior to the receipt of any funds from Banana.⁷⁰

Moreover, the ADOT transactions were well documented. ADOT had an Intercompany Agreement with MOD Systems,⁷¹ as well as a

⁶⁶ Ex 208

⁶⁷ Ex 55

⁶⁸ Ex 66

⁶⁹ Ex 103

⁷⁰ Ex 107

⁷¹ Ex 249

Service Agreement with Banana Corporation.⁷² It was established that ADOT was doing a significant amount of business both prior to and after the influx of Banana funds and had documented its transactions.

The trial court enumerated that ADOT sent: a) \$150,000 wire to Phillips entities; b) \$500,000 and \$25,000 wires to Mr. Phillips; c) \$50,000 wire to a foreign account; d) \$705,000 for Mr. Phillips' income tax payments, and that Mr. Phillips received a \$1,160,00 consulting fee from Banana.

First, it is undisputed that Mr. Phillips did perform work on behalf of Banana. Mr. Phillips testified specifically about the work performed for Banana⁷³ and how that work differed from those services provided by ADOT to Banana.⁷⁴ The testimony and documentation presented at trial demonstrate that a) Mr. Phillips was doing a significant amount of work for Banana and b) the consulting fee paid to Mr. Phillips was fair and reasonable. The court found that none of these transactions had been disclosed to Mr. Arnold. Specifically, the court found the testimony of Cole Younger and Julia de Haan credible on the issue.⁷⁵ This is substantially rebutted by the trial court record. Ms. de Haan testified the subscription agreement containing disclosures had Mr. Arnold's signature

⁷² Ex 207

⁷³ RP 2-26-13 176: 4-25

⁷⁴ RP 2-26-13 176:18 to 178:21

⁷⁵ CP 240:8

on it.⁷⁶ She admitted to not knowing what documents were exchanged between Mr. Phillips and Mr. Arnold.⁷⁷ The “fact” witness, Mr. van Drunen, testified that his report contained no clear indications as to what disclosures were made; only that this is what he believed he gleaned from the course of interviewing Mr. Phillips.⁷⁸ In addition, he admitted to not knowing if Mr. Arnold ever consented to a conflict of interest.⁷⁹ In contrast, Mr. Mandell interviewed Mr. Phillips and found adequate disclosures had been made.⁸⁰

The shareholders of a corporation can ratify a director's breach of his fiduciary duty and a related party transaction, provided the shareholders receive full and complete disclosure of all relevant facts. *State ex rei. Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wn.2d 375,391 P.2d 979 (1964); *Saviano v. Westport Amusements, Inc.*, 144 Wn. App. 72, 180 P.3d 874 (2008). Extensive testimony and documentation supported Mr. Phillips’ assertion that Mr. Arnold was provided with full and complete disclosure of all transactions and approved or ratified them. The Banana Subscription Agreement provides in Section 3.1 that Mr. Arnold had received “all information that the Investor has requested regarding the

⁷⁶ RP 2-19-13 11:14-15; 12:16-18; Ex 200

⁷⁷ RP 2-19-13 17:9-16

⁷⁸ RP 2-19-13 61:25; 72:25; 92:1-22

⁷⁹ *Id.* at 133

⁸⁰ RP 2-21-13 96:24 to 97:11; 173:9 to 176:5; 177:16 to 178:7

current and proposed relationship between the Company, ADOT Corporation and Hello Twice Corporation, including the contractual relationships, the overlap of management, and the sharing of resources among such entities.”⁸¹ Mr. Phillips testified that he provided every relevant document regarding Banana, ADOT, MetaWallet and MOD Systems to Mr. Arnold and had discussions regarding nearly every document.⁸² Mr. Lower confirmed that relevant documents were provided to Mr. Arnold.⁸³ Also, Mr. Mandell testified that the disclosure provided to Mr. Arnold was sufficient.⁸⁴

Mr. Arnold could not contradict this testimony to the Court with any direct evidence. Mr. Phillips repeatedly attempted to obtain Mr. Arnold’s deposition. Mr. Arnold’s absence at trial creates a question of law as to the prejudicial effect on Mr. Phillips as discussed in section 2 given that Mr. Arnold could prove or disprove the essential factual issues in this matter, especially in light of the fact that those factual issues were determined by testimony from a non-expert witness.

Second, Mr. van Drunen testified he did not know the nature of the business that the \$50,000 foreign wire was transferred to LG Innotek⁸⁵, a

⁸¹ Ex 207

⁸² RP 2-26-13 44-50, 56-61, 70-71, 76-78, 80-84, 89-90, 101-103, 118-119, 136-139

⁸³ RP 2-26-13 107-109

⁸⁴ RP 2-21-13 122-123

⁸⁵ RP 2-20-13 41:6-7

legitimate and typical purchase for hardware components, and did not follow that transaction or the other foreign wires from “cradle to grave.”⁸⁶

Third, Mr. Mandell testified the consulting fee was proper and had a business purpose and, most importantly, Banana did not suffer damages as the result of Mr. Phillips’ actions.⁸⁷ Mr. Mandell also testified that Mr. Phillips worked in good faith to correct any deficiencies in the assignments between the companies.⁸⁸

Fourth, there is no substantial evidence to support that the MetaWallet entity was a separate entity from Banana, contrary to FOF #25.⁸⁹ Mr. Mandell determined that the MetaWallet company and Banana were treated as the same company.⁹⁰ Moreover, at the time Mr. Mandell made this determination, he was fully aware that MetaWallet was a Washington corporation, not a d/b/a.⁹¹ Mr. Mandell was aware of the NuevaTel Agreement, all assignment agreements, the relationship between the relevant entities, and the technologies developed and utilized by the companies. Mr. Mandell determined that MetaWallet and Banana should be treated as the same company.⁹² Additionally, Mr. Phillips repeatedly

⁸⁶ RP 2-20-13 24:6-10

⁸⁷ RP 2-20-13 141:6-16

⁸⁸ RP 2-20-13 136:3-15

⁸⁹ RP 7-23-13 87-95

⁹⁰ RP 2-21-13 54:15-18

⁹¹ Id.

⁹² Id.

testified that MetaWallet was essentially a d/b/a of Banana that had been created prior to Mr. Arnold's investment⁹³ and it was created as a separate corporation as a result of a scrivener's error by Mr. Gordon and that the intent was always to merge the two companies.⁹⁴ Mr. Gordon, who the court found credible, testified that a d/b/a was filed for Banana, but the MetaWallet name was misspelled which caused "a bunch of controversy through this whole process." Mr. Gordon further testified that MetaWallet was essentially the marketing arm of Banana and it was intended that a contractual relationship be established between the two entities.⁹⁵ Moreover, Mr. Phillips disclosed the existence of the MetaWallet company to Mr. Arnold and provided the NuevaTel agreement to Mr. Arnold.⁹⁶ The intention to merge MetaWallet and Banana is further supported by a letter from Ronald E. Braley at Lasher Holzapfel Sperry & Ebberson to Plaintiff's counsel. Mr. Braley states: "(o)wnership of Meta Wallet still needs to be transferred to Banana. That is in process."⁹⁷ Also, as noted in the Mako Analysis, once Mr. Phillips was made aware of the Arnold complaint, he assigned all rights in both Banana and MetaWallet to

⁹³ CP 228, p. 2

⁹⁴ RP 2-21-13 7:22 to 8:4; RP 2-26-13 14, 15:6-18; 83:6-18

⁹⁵ RP 2-6-13 35:22-25; 168:19-25, 169:1-10

⁹⁶ RP 2-6-13 167:22-25; RP 2-26-13 49:23-25; 50:1

⁹⁷ Ex 253

the new board of directors.⁹⁸ Importantly, the KMPG report acknowledged that the MetaWallet name was used interchangeably with Banana. The report also affirmed the intention to combine the two companies into one.⁹⁹

Again, Mr. Arnold's absence at trial coupled with Plaintiff's counsel's continual and aggressive refusal to permit his deposition caused extreme prejudice to Mr. Phillips, whose testimony could have helped resolve another material issue as to whether disclosures had been made to him.

6. The Trial Court Erred In Finding Banana Had Suffered Damages.

Mr. Arnold was assigned the claims of Banana in this matter. At the time Mr. Arnold entered into the Subscription Agreement, he and Mr. Phillips were the only shareholders of Banana. The Subscription Agreement included specific language that not only notified Mr. Arnold of Mr. Phillips' other interests in sister companies, but Mr. Phillips was also given wide authority in the management of the companies. Mr. Phillips testified that he regularly updated Mr. Arnold on the progress of Banana (and on MOD) and that he disclosed all relevant transactions, including

⁹⁸ In contrast, Ms. de Haan admits the impetus for the lawsuits was the dilution of Mr. Arnold's shares in MOD, even though he had clearly waived any right to object to a reduction of his shares in the Subscription Agreement.

⁹⁹ Ex 228, Appendix D, p. 27-28

the “related-party transactions.” That testimony is supported, in part, by Maureen Lower, who personally saw Mr. Phillips in Mr. Arnold’s office on numerous occasions, and sat in on some of those meetings.¹⁰⁰ There is no competent evidence that rebuts Mr. Phillips’ testimony on this issue.

Since Mr. Arnold and Mr. Phillips were the only shareholders of Banana, any action approved by them cannot be the basis of a damage award in favor of the corporation. The only evidence before the court was that all shareholders of Banana agreed to the actions undertaken by Banana during the relevant period. Mr. Arnold was either personally informed of all actions undertaken by Mr. Phillips during their numerous meetings, or he specifically agreed to and ratified all actions by entering into the Subscription Agreement. As the testimony of Maureen Lower makes clear, Mr. Arnold had invested in approximately 100 start-up companies, yet kept a “hands-off” approach to the companies, allowing the directors and officers to manage and operate the companies as they saw fit.¹⁰¹ By definition Mr. Arnold was a “sophisticated” investor. At any time, he could have demanded more documentation or information than was provided to him; presumably these demands would have been put in writing. But as the evidence demonstrates, there were no regular or formal updates from any of the many companies in which he had invested.

¹⁰⁰ RP 2-20-13 145:5-21

¹⁰¹ RP 2-20-13, 115:15 to 116:6

Mr. Phillips stood out from the rest of the start-ups in the number of meetings that he had with Mr. Arnold to keep him advised of developments in the companies. The only evidence before the Trial Court was that all shareholders of Banana agreed to the actions undertaken by the company and therefore precludes any claim for damages by the company. *Interlake Porsche v. Bucholz*, 45 Wn. App. 502, 728 P.2d 597 (1986).

Additionally, the trial court improperly shifted the burden of proof in proving the damages to Mr. Phillips. Once a fiduciary's self-dealing for personal benefit has been established, the burden to prove the "benefit" to the company does not shift to the fiduciary. Such a holding would impose upon corporate fiduciaries a higher burden than the law requires, and would expose corporate fiduciaries to liability many times in excess of the damage their own actions may have caused. *Id.* at 512. A plaintiff bears the burden to show a causal link between the breach of a fiduciary duty (i.e. corporate waste) and damages. The duty of reimbursement is limited to those losses that were proximately caused by the fiduciary's misconduct. *Id.* Mr. Arnold did not present any evidence that those expenditures constituted corporate waste. Mr. Arnold did not and could not meet his evidentiary burden regarding damages.

In denying Mr. Phillips' motion to dismiss following Mr. Arnold's case in chief on this basis, the trial court adopted, without admission, the standard that had been rejected in *Interlake Porsche*.¹⁰² Even if *Interlake Porsche* requires the burden to shift where the transaction involves self-dealing, Mr. Phillips has met this evidentiary burden with testimony that was un rebutted. The only evidence presented to the court was that there were no damages to Banana because of the agreement of the shareholders and when the Trial Court awarded damages to Banana, it did so by improperly shifting the burden of proving damages to Mr. Phillips.

7. The Trial Court Erred In Finding That ADOT Was Liable To Banana For Breach Of The Loan Agreement.

Banana and ADOT entered into a loan agreement, which loan was to be repaid in September of 2011.¹⁰³ Mr. Mandell found that the loans to ADOT were to fund research and development for both MetaWallet and MOD. Moreover, Mr. Mandell found that the loan was "well documented."¹⁰⁴ Mr. Phillips testified to this fact as well.¹⁰⁵ Importantly, Mr. Phillips testified that Mr. Arnold was informed about this loan and did not question it.¹⁰⁶ Mr. Phillips has demonstrated that the loan from Banana to ADOT would ultimately benefit Banana, as ADOT was using

¹⁰² RP 2-20-13 100-108

¹⁰³ CP 240

¹⁰⁴ RP 2-21-12 104:25 to 105:18

¹⁰⁵ RP 2-26-12 134:25; 135:1-24

¹⁰⁶ RP 2-26-12 135:7 to 136:10

the loan proceeds to develop hardware and software that would be used by Banana. No substantive evidence to the contrary was presented.

8. There Was No Substantial Evidence To Support FOF 27 That The Lower Consulting Fee Was A Related-Party Transaction.

The Trial Court found that the consulting fee paid to Mr. Lower was a related-party transaction. Pursuant to RCW 23B.08.720, if a director has a conflicting interest in a transaction, the transaction must be fully disclosed and approved by a majority of qualified directors. A “conflicting interest” means “the interest a director... has respecting a transaction effected... by the corporation..., if: (a) [w]hether or not the transaction is brought before the board of directors of the corporation for action, the director knows at the time of commitment that the director or a related person is a party to the transaction or has a beneficial financial interest in or so closely linked to the transaction and of such financial significance to the director... that the interest would reasonably be expected to exert an influence on the director’s judgment....” RCW 23B.08.700(1).

A related party is defined as “the spouse, or a parent or sibling thereof, of the director, or a child, grandchild, sibling, parent, or spouse of any thereof, of the director, or an individual having the same home as the

director, or a trust or estate of which an individual specified herein is a substantial beneficiary.... RCW 23B.08.700(a).

The “related-party” transactions involve only Mr. Lower and Banana. Mr. Lower is not a related party to Mr. Phillips, as provided in RCW 23B.08.700(3). Mr. Phillips was not a party to the transactions discussed nor did Mr. Phillips receive a beneficial interest of financial significance in the transactions. The court erred when finding that this transaction was a related-party transaction or conflict of interest on the part of Mr. Phillips.

Mr. Arnold continually asserted that the consulting fee paid to Mr. Lower was a finder’s fee for inducing Mr. Arnold to invest in Banana. This fails to recognize that Mr. Lower did a significant amount of work for Banana and took a significant risk when he left a full time job to take the position with Banana. Moreover, Mr. Arnold has failed to provide any credible evidence that Mr. Lower was paid a finder’s fee. On the contrary, Mr. Phillips has presented both testimony and documentation to rebut this assertion. Specifically, Mr. Mandell testified that the consulting was not a finder’s fee,¹⁰⁷ Mr. Phillips testified it was not a finder’s fee,¹⁰⁸ Mr. Lower himself testified it was not a finder’s fee,¹⁰⁹ and there is an Independent

¹⁰⁷ RP 2-21-13 103:18 to 104:4; Ex 228

¹⁰⁸ RP 7-29-13 114:1-4

¹⁰⁹ RP 2-26-13 101:1-3

Contractor Agreement between Mr. Lower and Banana to document their relationship.¹¹⁰

9. Banana Waived Its Right To Any Recovery From Mr. Phillips On The Lower Loan And Consulting Contract When Mr. Arnold Settled On Behalf of Banana.

Mr. Arnold was assigned all rights of Banana against Mr. Phillips, ADOT and the Lowers. Prior to commencing trial, Mr. Arnold settled with the Lowers for those claims assigned to him by Banana. Nevertheless, during trial Mr. Arnold argued that he should be awarded damages for the loan made to the Lowers (\$200,000) as well as the consulting contract with Doug Lower (\$450,000). In essence, the corporation (Banana) sued and settled with the Lowers for breach of the loan and the consulting agreement and then sued Mr. Phillips for those very same damages.

Based upon the equitable defenses of Estoppel and Waiver, Mr. Arnold waived any claim for repayment of the note and is further estopped from asserting such a claim. On or about January 28, 2013, Mr. Arnold dismissed Doug and Maureen Lower from this case. Mr. Lower testified that Banana, through Mr. Arnold, forgave the Note and fully released and discharged any and all claims it had against the Lowers.¹¹¹ Waiver is the intentional relinquishment of a known right. The doctrine of waiver

¹¹⁰ Ex 212

¹¹¹ RP 2-26-13 105:11 to 106:8

provides that “[o]nce a party has relinquished a known right or advantage, he cannot reclaim it without the consent of his adversary. Three elements must be present to create an estoppel: (1) an admission, statement, or act inconsistent with the claim afterwards asserted, (2) action by the other party on the faith of such admission, statement, or act, and (3) injury to such other party resulting from allowing the first party to contradict or repudiate such admission, statement, or act. *In re Estate of Boston*, 80 Wn.2d 70, 491 P.2d 1033 (1971), *Peplinski v. Campbell*, 37 Wn.2d 857, 226 P.2d 211 (1951).

The elements of both waiver and estoppel are present in the instant matter. The corporation and Mr. Arnold are barred from pursuing a claim against Mr. Phillips on the forgiven note. By settling with the Lowers, Mr. Arnold is attempting to improperly “stack” the damages against Mr. Phillips. Mr. Phillips has no right to make a claim against the Lowers. Any indemnification he receives is due entirely to the whim of Mr. Arnold, and subject to manipulation by Mr. Arnold.

10. The Trial Court Erred In Calculating Total Damages Against Mr. Phillips And ADOT.

The FOF and COL provide for a judgment against ADOT in an amount equal to the unpaid portion of the promissory note between Banana and ADOT. The judgment against Mr. Phillips includes a large

portion of those funds provided to ADOT by Banana on the promissory note. In its current form, the judgment allows Mr. Arnold to double dip and collect against both ADOT and Mr. Phillips for the funds loaned to ADOT by Banana.

The judgments against Mr. Phillips and ADOT are based on separate theories and separate transactions and thus the parties cannot be jointly and severally liable for one debt because, in fact, the awarded sums are not the same. Additionally, it should be made clear in the judgment that any payment made by ADOT against the judgment associated with those funds loaned from Banana to ADOT should reduce the judgment against Mr. Phillips.

Next, the trial court included the amounts of \$150,000 and \$500,000, which amounts were wired from ADOT to Phillips. The testimony before the trial court was that ADOT had other sources of income during the years of 2006 and 2007, and that Mr. Arnold's *de facto* expert, Mr. van Drunen, did not trace these transactions from "cradle to grave."¹¹² The result was that there is no competent evidence that the transactions were related to "Banana" money, and, given the disparity between Mr. Arnold's investment and the amount of damages, there was a strong inference that these payments were unrelated to the Banana money.

¹¹² RP 2-20-13 24:6-9

Mr. Mandell's unrebutted testimony also noted that Mr. Phillips was owed \$2.5 million for a one time licensing fee for his intellectual property.¹¹³ The value of the intellectual property contributed by Mr. Phillips to Banana was estimated to be \$60 million. At a minimum, Mr. Phillips is entitled to a "credit" for the \$2.5 million fee that was never paid to him by Banana.

CONCLUSION

For the reasons set forth hereinabove, Appellants Mr. Phillips and ADOT respectfully submit that the trial court erred in granting a partial summary judgment against Mr. Phillips and ADOT. The Court had received and reviewed competent evidence demonstrating triable issues of fact for both Mr. Phillips and ADOT. Once the case went to trial, the trial court committed error in failing to demand the presence of and/or preserve the testimony of Mr. Arnold without granting remedial sanctions, failing to properly weigh the evidence in entering its Findings of Fact, and failing to properly calculate damages (an amount which exceeded the total investment of Mr. Arnold). Appellants respectfully request this Court vacate the order granting partial summary judgment in favor of Mr.

¹¹³ RP 2-21-13 126:7 to 127:12; Ex 228; Ex 39

Arnold and order a new trial to address all of the issues raised by Mr. Phillips and ADOT.

DATED this 30th day of May, 2014.

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CERTIFICATE OF SERVICE

On May 30, 2014, I caused a true and correct copy of the attached pleadings to be delivered by process of service via U.S. Postal Service, hand delivery, and/or e-mail to the following:

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OF THE STATE OF WASHINGTON
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Dated at Seattle, Washington, this 30th day of May, 2014.

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