

FILED  
BY: 

No. 35519-1-II

COURT OF APPEALS, DIV. II  
OF THE STATE OF WASHINGTON

---

Cathryn Chudy, Emmy Winterburn, and Kathryn Edgecomb, on behalf of Columbia Credit Union, and Cathryn Chudy, Emmy Winterburn, and Kathryn Edgecomb, as individuals, Appellants,

vs.

Duane Bequette, Steve Straub, John Cheek, Mark Ail, Robert Byrd, and Parker Cann, Respondents,

and

Columbia Community Credit Union, Intervenor-Respondent.

---

APPELLANTS' REPLY BRIEF

---

*Attorneys for Appellants:*

Douglas A. Schafer (WSBA 8652)  
Schafer Law Firm  
950 Pacific Ave., Suite 1050  
P.O. Box 1134  
Tacoma, WA 98401-1134  
(253) 431-5156

Peggy Hennessy, WSBA# 17889  
Reeves, Kahn & Hennessy  
4035 S.E. 52<sup>nd</sup> Ave.  
P.O. Box 86100  
Portland, OR 97286  
(503) 777-5473

**TABLE OF CONTENTS**

COMMENT ON MOTION TO MODIFY ..... 1

ARGUMENTS IN REPLY ..... 1

    1. Stated claims of unlawfulness against Defendant Directors  
    and CEO. .... 1

    2. Applicability of corporate common law to credit unions. .... 3

    3. DFI impotence to adjudicate governance issues. .... 6

    4. Claim on behalf of Columbia Community Credit Union. .... 7

    5. Claim for indemnification pursuant to Columbia’s Articles of  
    Incorporation. .... 9

**TABLE OF AUTHORITIES**

**Cases**

*Burk v. Cooperative Finance Corp.*, 62 Wn.2d 740, 748 384 P.2d 618  
(1963) ..... 4

*Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339 (Del.Supr. 1983) ..... 11

*King County Dep’t of Cmty. & Human Servs. v. NW Defenders Ass’n*, 118  
Wn. App. 117, 123, 75 P.3d 583 (2003) ..... 8

*LaHue v. Keystone Inv. Co.*, 6 Wn. App. 765, 776, 496 P.2d 343 (1972)  
..... 7

*Lundberg v. Coleman*, 115 Wn. App. 172, 60 P.3d 595 (2002), *rev.  
denied*, 150 Wn.2d 1010 (2003) ..... 7

*Ridenour v. Andrews Federal Credit Union*, 897 F.2d 715, n.4 (4th Cir.  
1990) ..... 5

<i>Save Columbia CU Comm. v. Columbia Community Credit Union</i> , 134 Wn. App. 175, 139 P.3d 386 (2006) .....	5
<i>Stifel Fin. Corp. v. Cochran</i> , 809 A.2d 555 (Del.Supr. 2002) .....	11

**Statutes**

1987 Laws of Washington Ch. 457 §§ 3, 6 .....	4
1989 Laws of Washington Ch. 307 § 1 .....	4
1997 Laws of Washington Ch. 397 § 19 .....	3
1997 Laws of Washington Ch. 397 § 30 .....	10
RCW 23.78.020 and .050 .....	4
RCW 23.86.360 .....	4
RCW 23B.08.300(1) .....	3
RCW 23B.08.500 through 23B.08.600 .....	10
RCW 23B.17.030 .....	10
RCW 24.03.095 .....	8
RCW 24.03.250 - .295 .....	8
RCW 31.12.225(1) .....	8
RCW 31.12.255 .....	2
RCW 31.12.267 .....	2
RCW 31.12.365(2) .....	10
RCW 31.12.402 (22) .....	10
RCW 31.12.408(a) .....	5

RCW 31.12.625 .....	7
RCW 31.12.633 .....	6
RCW Ch. 23.86 .....	4
RCW Ch. 34.05 .....	7

**Other Authorities**

18 Am. Jur. 2d Cooperative Associations § 12 .....	4
70 Fed. Reg. 40924 (July 15, 2005) .....	5
72 Fed. Reg. 20061 (April 23, 2007) .....	5
CR 12(b)(6) .....	9, 11
CR 23.1 .....	7
CR 8(a) .....	2, 3
RAP 17.4(e) .....	1

## COMMENT ON MOTION TO MODIFY

Defendant Directors and other respondents included within their Brief of Respondents a Motion to Modify a ruling of this Court's Commissioner that denied Respondents' Motion to Dismiss on mootness grounds.

Plaintiff Directors do intend to submit a written answer to the Motion to Modify. RAP 17.4(e) permits an answer to such a motion to be made within a brief of the answering party —*but does not require that it be made within a brief*. That rule provides, in relevant part:

“If the motion is to be determined without oral argument, the court will set a date for the filing of the answer to the motion. If the motion is set for oral argument, the answer must be served and filed at least 4 days preceding the day of hearing.”

Plaintiff Directors' initial answer to the Motion to Dismiss included considerable relevant information about a pending case in Thurston County Superior Court that involves the parties. Developments are continuing in that case which may affect the mootness issue. Upon receipt of a notice from this Court pursuant to RAP 17.4(e), Plaintiff Directors will file and serve an answer to the Motion to Modify.

## ARGUMENTS IN REPLY

### **1. Stated claims of unlawfulness against Defendant Directors and CEO.**

At pages 18 to 24 of the Respondents' Brief, they mistakenly assert that Plaintiff Directors, in their trial court complaint, failed to allege

unlawful conduct by the Defendant Directors and CEO. They assert that Plaintiff Directors merely alleged “a situation in which different directors have a difference of opinion on conducting the affairs of the credit union.” Resp. Br. 18. Superior Court Civil Rule 8(a) requires a complaint to contain “a short and plain statement of the claim showing that the pleader is entitled to relief.” Plaintiff Directors satisfied CR 8(a).

In Paragraph 7 of the Complaint (CP 2), Plaintiff Directors alleged:

“Defendants control the records of CCCU. They have engaged in a pattern and practice of denying Plaintiffs access to examine and copy corporate records to which Plaintiffs are entitled by law to examine and copy due to their positions as Directors.”

In Paragraph 10 of the Complaint (CP 3), Plaintiff Directors alleged:

“Defendants actions of denying Plaintiff Directors access to records, excluding Plaintiff Directors from meetings, and prohibiting Plaintiff Directors from registering their objections in Board meeting minutes have prevented Plaintiff Directors from exercising the duties and powers set forth in RCW 31.12.255.”

In Paragraph 11 of the Complaint (CP 3), Plaintiff Directors alleged:

“Defendants have prevented Plaintiff Directors from fulfilling their fiduciary obligations as Directors, pursuant to RCW 31.12.267, by denying them access to information necessary to discharge their duties and denying them their other rights as Directors.”

Plainly stated, Plaintiff Directors did not allege merely a difference of opinion with the Defendant Directors and CEO. They alleged the violation of their rights as directors that arise from their statutory duties.

Respondents appear to suggest, at Resp. Br. 19, that RCW 31.12.267

(setting a fiduciary standard of care for directors and senior officers) is the sole source of a duty for them. That statute recently was added to the Washington Credit Union Act (WCUA) in 1998 to match the general standards of care for directors as stated in the Washington Business Corporation Act, RCW 23B.08.300(1). 1997 Laws of Washington Ch. 397 § 19. Opening Br. 19. A standard-of-care provision such as those may afford a *defense* to a director or senior officer accused a breaching his or her duty of care, but a party alleging their unlawful conduct need not allege the inapplicability of that defense in order to state a claim, consistent with CR 8(a).

## **2. Applicability of corporate common law to credit unions.**

At page 19 of the Respondents' Brief, they assert that "the fact that [the Washington State Department of Financial Institutions (DFI)] may ... look to corporate law as instructive ... is not a basis for the court to do so." In their Opening Brief, at 4 - 18, Plaintiff Directors demonstrate that credit unions, as cooperative *corporations* under Washington law since 1933, have followed the structural paradigm of general corporations with members' rights parallel to shareholders' rights, and that the Washington state supervisory authority, now DFI, has referred to general corporate law whenever the WCUA was silent on a governance issue. It is settled common law that the general laws applicable to corporations apply to

incorporated cooperatives. 18 Am. Jur. 2d Cooperative Associations § 12 (“Because a cooperative association organized in corporate form is basically a corporation, the general laws relating to corporations apply also to incorporated cooperatives.”)

The Washington State Supreme Court in 1963 referred to general corporate law, as well, when addressing a governance issue affecting a financial cooperative—a creature of statute—organized under then RCW Ch. 23.86, the Washington Cooperatives Act. In *Burk v. Cooperative Finance Corp.*, 62 Wn.2d 740, 748 384 P.2d 618 (1963), the Court found no statute in the Washington Cooperatives Act applicable to the governance issue of whether the cooperative might repurchase its own stock. The Court examined provisions concerning stock in the general corporation statutes and in the Cooperatives Act and found “parallelism to a substantial degree.” *Id.* at 743. Thus, the Court ruled that the cooperative may repurchase its stock under the same conditions that applied by statute to general corporations in Washington. *Id.* at 748 <sup>1</sup>.

Given the substantial parallelism with respect to the elected directors

---

<sup>1</sup> In 1989, the Washington state legislature substantially revised the Washington Cooperatives Act, RCW Ch. 23.86, finding that “[t]hese cooperative incorporation statutes have not been updated with the regularity of this state’s business incorporation statutes and, as a result, are deficient in certain respects.” 1989 Laws of Washington Ch. 307 § 1. That revision added RCW 23.86.360, stating that “The provisions of [the Washington Business Corporation Act, now codified at Title 23B RCW] shall apply to the associations subject to this chapter, except where such provisions are in conflict with or inconsistent with the express provisions of this chapter.” *Id.* § 32. The legislature in 1987 had expressly declared applicable to employee cooperatives the Washington Business Corporations Act, with members having the rights of shareholders of business corporations. RCW 23.78.020 and .050. 1987 Laws of Washington Ch. 457 §§ 3, 6.

of general corporations under RCW Ch. 23B.08 and elected directors of credit unions under RCW 31.12, this court should apply the law applicable to general corporations to issues not squarely addressed in RCW 31.12.

The National Credit Union Administration (NCUA), which insures the deposits of Columbia and all Washington credit unions (RCW 31.12.408(a)) and is the primary regulator for federal credit unions (FCUs), has a long history of abstention on credit union internal governance disputes, leaving them for resolution by state courts applying the state's general corporate law. *E.g., Ridenour v. Andrews Federal Credit Union*, 897 F.2d 715, n.4 (4th Cir. 1990); 70 Fed. Reg. 40924, 40930 (July 15, 2005) (“[G]enerally state corporate law, to the extent it is consistent with the Federal Credit Union Act and NCUA regulations, determines disputes regarding the enforcement of bylaw provisions. Therefore, NCUA generally does not become involved in resolving internal governance disputes in federal credit unions involving bylaw disputes unless a matter presents a safety and soundness concern.”)

In large part due to this Court's shocking opinion in *Save Columbia CU Comm. v. Columbia Community Credit Union*, 134 Wn. App. 175, 139 P.3d 386 (2006), the NCUA has determined not to rely on state courts to resolve all credit union governance disputes. In the introductory background to its recently proposed rule titled “Member Inspection of Credit Union Books, Records, and Minutes,” 72 Fed. Reg. 20061 (April

23, 2007), the agency stated, at 20062:

“The NCUA Board believes regulating member inspection rights of FCU records is preferable to reliance on state corporation law. ... [S]ome courts may refuse to apply their corporation law to inspection requests by FCU members or may incorrectly analogize the financial interests of credit union members to those of depositors in a mutual savings bank and deny members inspection on those grounds. *See, e.g., Save Columbia Credit Union Committee v. Columbia Credit Union*, 139 P.3d 386, 393–95 (Wash. App. 2006) (refusing to apply state corporation law to records inspection request by members of a state-chartered credit union).”

Until this Court’s 2006 *Save Columbia* ruling, lawyers and regulators concerned with state and federal credit unions always viewed state general corporate law as applicable to credit union governance issues that were not squarely addressed in a credit union statute. That case was wrongly decided and should be limited to its facts, if not simply overruled.

### **3. DFI impotence to adjudicate governance issues.**

At pages 23 and 30 of the Respondents’ Brief, they assert that, because RCW 31.12.633 empowers DFI’s director, to *attend* a credit union’s board meetings, DFI is empowered to adjudicate governance disputes such those stated in Plaintiff Directors’ complaint. But as stated in the Opening Brief, at pages 27 - 28, DFI’s power has been substantially confined, since 1997 legislation, to enforcement actions that address a threat to the financial soundness of a credit union as a depository

institution. DFI has no effective way to adjudicate governance disputes or even to enforce the expressed governance provisions of RCW Ch. 31.12 without undertaking the multi-year process of holding an administrative hearing and obtaining an administrative law judge's order that withstands review by the superior court and appellate courts under the Administrative Procedures Act, RCW Ch. 34.05. RCW 31.12.625. Given DFI's primary focus on protecting consumers' deposits, it is unlikely to expend its limited budget litigating credit union governance disputes.

#### **4. Claim on behalf of Columbia Community Credit Union.**

At pages 26-28 of the Respondents' Brief, they assert that Plaintiff Directors' claim "on behalf of Columbia Community Credit Union" was properly dismissed. It is conceded that the requirements of CR 23.1 were not satisfied in pleading a derivative claim, but the appropriate action is to permit Plaintiff Directors to amend their complaint or to re-file it in a manner consistent with CR 23.1.

Respondents argue, based on *Lundberg v. Coleman*, 115 Wn. App. 172, 60 P.3d 595 (2002), *rev. denied*, 150 Wn.2d 1010 (2003), that directors cannot bring an action on behalf of the corporation they direct. But the *Lundberg* court utterly failed to consider the applicable procedural rule of court that governs just who may bring a judicial proceeding on behalf of a legal entity—CR 23.1. *LaHue v. Keystone Inv. Co.*, 6 Wn.

App. 765, 776, 496 P.2d 343 (1972).

In a contrasting case, *King County Dep't of Cmty. & Human Servs. v. NW Defenders Ass'n*, 118 Wn. App. 117, 123, 75 P.3d 583 (2003), brought by a contract creditor the very same appellate court ruled that a nonprofit corporation “forfeited its corporate rights because for years it has not had a legitimately functioning board of directors.” [Emphasis added.] The appellate court’s only anchor to the Nonprofit Corporation Act was RCW 24.03.095, cited by the court, at 121, for the requirement that “The affairs of a nonprofit corporation must be managed by a board of directors.” (Comparable to RCW 31.12.225(1) (“The business and affairs of a credit union shall be managed by a board ... of directors.”).) The appellate court simply ignored the involuntary dissolution provisions of the Nonprofit Corporation Act (RCW 24.03.250 - .295) and declared the corporation to have “forfeited its corporate rights,” then approved the trial court’s appointment of a receiver at the behest of the creditor to act *for the benefit of the corporation*. *Id* at 121, n.1.

The *NW Defenders* case very well illustrates the inherent power of the Washington Court of Appeals to create corporate common law without being constrained by statutory enactments, in unexplainable contrast to the statutorily constrained analysis by the very same court a very few months earlier in the *Lundberg* case.

The *NW Defenders* case further illustrates that a board of directors

that is not functioning properly—with each director empowered to fulfill their responsibilities—presents a grave risk to a corporation, for even a creditor might be permitted by a court to obtain the appointment of a receiver to act *for the benefit of the corporation*. A corporation, including a credit union, has a right to lawful governance.

**5. Claim for indemnification pursuant to Columbia’s Articles of Incorporation.**

At pages 30-33 of the Respondents’ Brief, they assert that Plaintiff Directors “alleged no claim for indemnification, and even if they had, no such claim exists under these circumstances.”

In Paragraph 13 of the Complaint (CP 4), Plaintiff Directors alleged:

“Plaintiff Directors are entitled to indemnification, from CCCU, for their expenses, including attorney fees, relating to this action, which arise from the fact that they are directors, pursuant to CCCU’s Articles of Incorporation.”

The substantive analysis suggested by Respondents is that Plaintiff Directors have not stated a claim, cognizable under Washington law, for indemnification of their expenses relating to this action because they brought the action as plaintiffs. Resp. Br. At 32.

For purposes of measuring Plaintiff Directors’ claim for indemnification against the standards of CR 12(b)(6), the court may assume that Columbia’s articles of incorporation require it to indemnify its directors against all liability, damage, or expense resulting from the fact

that the person was a director to the maximum extent and under all circumstances permitted by law.

RCW 31.12.365(2) expressly states that credit union directors “may receive reimbursement for reasonable expenses incurred ... in the performance of the directors’ ... duties.”

Respondents cite RCW 31.12.402 (22), which expressly empowers credit unions to indemnify their directors and others pursuant to provisions in their articles of incorporation or bylaws “that conform to RCW 23B.08.500 through 23B.08.600.” The referenced provisions of RCW 23B (Washington Business Corporation Act) limit the circumstances in which a corporation may indemnify a director against liability from a proceeding to which she was made a party because of being a director.<sup>2</sup> Those provisions do not prevent a corporation, including a credit union, from reimbursing a director for expenses, including attorney fees, incurred in a good faith effort to perform her responsibilities as a director, including possibly bringing a declaratory judgment action for that purpose. It is well established by case law that broadly-worded indemnification language in a corporation’s articles of incorporation or bylaws may require it to indemnify directors who bring actions as plaintiffs in a good faith effort to perform their responsibilities or to

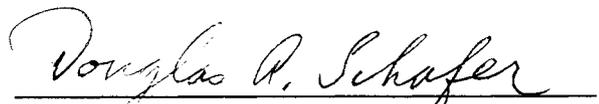
---

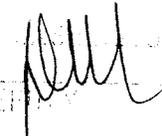
<sup>2</sup> The limitations on a corporation’s power to indemnify against liability its directors, as stated in RCW 23B.08.500 to .600 have been applicable to Washington credit unions since 1989 by virtue of RCW 23B.17.030. RCW 31.12.402(22) was unnecessarily added to the Washington Credit Union Act in 1997. 1997 Laws of Washington Ch. 397 § 30.

enforce their rights as directors. *Hibbert v. Hollywood Park, Inc.*, 457 A.2d 339 (Del.Supr. 1983); *Stifel Fin. Corp. v. Cochran*, 809 A.2d 555 (Del.Supr. 2002).

There was no basis for the trial court to dismiss under CR 12(b)(6) Plaintiff Directors' claim for indemnification.

Respectfully submitted this 24th day of April, 2007.

  
\_\_\_\_\_  
Douglas A. Schafer, Attorney for Appellants  
WSBA No. 8652

07 APR 2007 10:16 AM  
STATE COURT  
BY 

**In the Court of Appeals for the State of Washington  
Division II**

**Cathryn Chudy, Emmy Winterburn, and  
Kathryn Edgecomb, on behalf of Columbia  
Credit Union, and Cathryn Chudy, Emmy  
Winterburn, and Kathryn Edgecomb, as  
individuals, Appellants,**

**No. 35519-1-II**

**Proof of Mailing of Appellants' Reply Brief.**

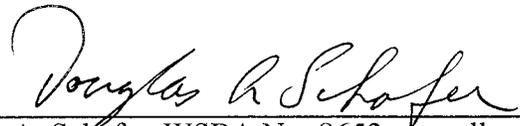
vs.

**Duane Bequette, Steve Straub, John  
Cheek, Mark Ail, Robert Byrd, and Parker  
Cann, Respondents.**

Douglas A. Schafer, attorney for Appellants, state that today I e-mailed and also mailed by USPS First ClassMail a copy of Appellants' Reply Brief to opposing counsel of record, addressed as follows:

Heather Cavanaugh, Attorney  
Miller Nash LLP  
3400 US Bancorp Tower  
111 SW 5th Ave  
Portland, OR 97204

Date: April 24, 2007

  
\_\_\_\_\_  
Douglas A. Schafer, WSBA No. 8652, Appellant's Co-Counsel