

No. 35813-1

**COURT OF APPEALS, DIVISION 2
OF THE STATE OF WASHINGTON**

BAGELHEADS, INC. and ROBERT MACKEY, JR.,

Appellants

v.

DONALD KOSTEROW,

Respondent

**BRIEF OF APPELLANTS
BAGELHEADS, INC. and ROBERT MACKEY, JR.**

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INTRODUCTION

The issues presented by this appeal can be distilled into a single question: whether a jury's verdict can stand when the critical decisions reached by the jury are supported by no more than conjecture and supposition. Even a cursory review of the record shows that the jury's verdict cannot stand.

For example, the consulting agreement required Appellant Bagelheads, Inc. ("Bagelheads") to pay Respondent Donald Kosterow ("Kosterow") royalties on any "branch in which Robert Mackey, Jr. owns no less than fifty-one percent (51%)." *Ex. 21, p. 2*. Yet the jury found that Bagelheads owed royalties on the Pensacola Beach store, even though Mackey owned just 50.5% of the store.

The jury found that Mackey had breached the agreement's non-disclosure provision, even though Kosterow introduced no evidence that Mackey disclosed any information to any third party. Kosterow also never identified the information allegedly disclosed.

The jury awarded \$27,200 in damages to Kosterow for breach of the agreement's non-disclosure provision, even though Kosterow produced no evidence that he sustained a single dollar of damages from the alleged disclosure of this unidentified information.

While juries are given wide latitude to arrive at their decisions, their verdicts must be supported by the evidence. A jury's verdict must be grounded in fact, not speculation or argument. Because the verdict below is not supported by the evidence, the final judgment should be reversed.

ASSIGNMENTS OF ERROR

I. Assignments of Error

1. The trial court erred when it entered judgment for Kosterow on his claim that Bagelheads breached the consulting agreement by not paying Kosterow two percent of gross sales from the Pensacola Beach store.

2. The jury's verdict that Bagelheads and Mackey breached the consulting agreement by disclosing information they obtained from Kosterow was not supported by substantial evidence.

3. The jury's verdict requiring Bagelheads and Mackey to pay \$27,200 in damages for breaching the non-disclosure provision in the contract was not supported by substantial evidence.

4. Assuming this Court reverses on one or more of the first three assignments of error, the trial court also erred in awarding Kosterow \$39,600 in attorney's fees under the contract.

II. Issues Pertaining to Assignments of Error

1. The consulting agreement required Bagelheads to pay Kosterow royalties on any store in which Mackey owned “no less than fifty-one percent (51%).” Mackey owned just 50.5 percent of the Pensacola Beach store. Did the trial court err as a matter of law when it entered judgment requiring Bagelheads to pay royalties for the Pensacola Beach store? (Assignment of error number 1).

2. The consulting agreement required Bagelheads to pay Kosterow royalties on any store in which Mackey owned “no less than fifty-one percent (51%).” Kosterow introduced no evidence that 51 percent was intended to mean anything other than 51 percent. Mackey owned just 50.5 percent of the Pensacola Beach store. Was the jury’s verdict requiring Bagelheads to pay royalties for the Pensacola Beach store supported by substantial evidence? (Assignment of error number 1).

3. To prove breach of the contract’s non-disclosure provision, Kosterow was required to prove that Mackey disclosed information Kosterow had provided to him. Kosterow introduced no direct or circumstantial evidence that Mackey disclosed any of Kosterow’s information, nor did he identify the information allegedly disclosed. Was the jury’s verdict holding that Bagelheads and Mackey breached the non-

disclosure provision supported by substantial evidence? (Assignment of error number 2).

4. Breach of contract damages should place the plaintiff in the same position he would have been in had the contract been performed. Kosterow introduced no evidence that he sustained any damages from the alleged breach of the non-disclosure agreement. The jury's verdict provided Kosterow with a windfall that he would not have received had the contract been performed. Was the jury's award of damages supported by substantial evidence? (Assignment of error number 3).

5. The trial court awarded Kosterow attorney's fees and costs as the prevailing party under the attorney's fee provision in the contract. Assuming this Court reverses the judgment in Kosterow's favor on any grounds, should the award of attorney's fees be reversed as well? (Assignment of error number 4).

STATEMENT OF THE CASE

I. Nature of the Appeal

This is an appeal from a final judgment entered after a jury trial in favor of the Plaintiff-Respondent, Donald Kosterow ("Kosterow"), and against the Defendants-Appellants, Bagelheads, Inc. ("Bagelheads") and Robert Mackey, Jr. ("Mackey").

II. Statement of Facts

While there were numerous disputed facts presented in the testimony before the jury, the facts necessary to resolve this appeal are essentially undisputed. Recognizing the presumption in favor of sustaining jury verdicts, Bagelheads and Mackey will present disputed facts in this statement in the manner most favorable to Kosterow. Still, even accepting the facts in his favor is not enough to sustain the jury's verdict.

Robert Mackey, Jr. and his wife, Janet A. Mackey, are residents of Pensacola, Florida, located in Florida's panhandle. *RP vol. II, p. 121*. In 1995 or 1996, the Mackeys decided to start a small business in Pensacola and eventually decided to open a bagel restaurant. *RP vol. II, pp. 121-122*. Robert Mackey, who was a finance major in college, took a small business start-up course at the University of West Florida to educate himself on the requirements for running a small business. *RP vol. II, pp. 94, 122-123*. Robert Mackey traveled to more than 50 bagel stores throughout the Southeast to observe their operations, did research over the internet, and joined the American Bagel Association to learn more about the bagel industry. *RP vol. II, p. 123*. He spent a full year preparing a business plan for the restaurant. *RP vol. II, p. 124*.

To gain more specific knowledge about the operation of a bagel restaurant, the Mackeys eventually turned to Kosterow, a long-time friend

of Robert Mackey's father. *RP vol. I, pp. 99-100; vol. II, p. 130.* Like Mackey, Kosterow had started his own bagel restaurant with no prior experience after retiring from the pulp and paper industry. *RP vol. I, pp. 91-95, 192.* Over time Kosterow's business grew, and there are now eight Sunrise bagel stores in southern Washington. *RP vol. I, p. 97.* In the spring of 1997, Robert Mackey asked Kosterow about the possibility of serving as a consultant. *RP vol. I, p. 102.*

Kosterow and Mackey had several conversations about operating a bagel restaurant before they signed a formal consulting agreement. *RP vol. I, pp. 105-122.* These conversations included general discussions about the start-up costs for a bagel restaurant and about the location of equipment suppliers. *RP vol. I, p. 103.* In fact, before the parties had agreed to a consulting contract, Kosterow had already provided detailed information about his bagel business, including his production numbers, his suppliers, his tips on slicing, preparing, packaging, cooling and rotating meat to minimize waste, pricing information on his equipment, his suggestions on the proper layout for equipment in a bagel restaurant, and a detailed list of equipment needed to operate a bagel store. *RP vol. I, pp. 122-144.*

Eventually, Kosterow and Mackey entered into protracted negotiations over the terms of a potential consulting agreement. *RP vol. I, pp. 105-109; 111-112; 115-120; 145.* Both parties retained attorneys to

represent them in the negotiations, and the final agreement was the product of months of detailed arms-length negotiations between counsel. *RP vol. I, pp. 111-112; Exs. 6,8, 9, 10.*

On May 5, 1998, Kosterow and Bagelheads signed the written consulting agreement. *Ex. 21.* For purposes of this appeal, two provisions are critical. First, the agreement provided that Bagelheads would owe Kosterow two percent of its gross sales from each store owned by Bagelheads “or a branch in which Robert Mackey, Jr. owns no less than fifty-one percent (51%), arising from the sale of its bagel and related products for the initial consecutive four (4) year period of each bagel store location operation.” *Ex. 21, p. 2 (emphasis added).* Second, the agreement included a non-disclosure clause, which provided:

[Bagelheads] and its shareholders hereby covenant that it shall not divulge any of the information regarding the bagel operation business received from [Kosterow] nor shall it utilize any of such information in any bagel business operation other than one solely in conjunction with the family members of Robert Mackey, Jr., or one in which Robert Mackey, Jr. has no less than fifty-one percent (51%) ownership interest therein of which this Agreement shall apply.

Ex. 21, pp. 2-3.

After the consulting agreement was signed, the Mackeys spent several days visiting Sunrise bagel stores, where they observed Kosterow’s operations and learned his recipes for making bagels. *RP vol.*

II, pp. 35-37. The Mackeys took back with them the recipes for the bagels, along with handwritten notes on techniques for making bagels. *RP vol. II, p. 165.*

The Mackeys opened their Bagelheads restaurant in Pensacola in July of 1998. *RP vol. II, p. 73.* The restaurant specializes in coffee drinks and sandwiches. *RP vol. II, pp. 170.* The staff received its training in making coffee drinks from representatives of Bridgetown Coffee, the coffee supplier selected by Bagelheads for its restaurant. *RP vol. II, pp. 170-171.* Bagelheads learned to make sandwiches from representatives of Boar's Head, a well known deli supplier on the east coast. *RP vol. II, p. 171.* Bagelheads developed its own salad recipes and obtains its soups directly from vendors. *RP vol. II, pp. 172-73.* Janet Mackey and her brother developed the logo and color scheme for Bagelheads, and handled the décor for the restaurant. *RP vol. II, pp. 174.* Kosterow provided no assistance to Bagelheads in any of these areas. *RP vol. II, pp. 166-67, 171-174.*

Initially, Bagelheads used the bagel recipes provided by Kosterow in its Pensacola store. *RP vol. II, p. 178.* However, in late 1999 or early 2000, Bagelheads stopped using Kosterow's recipes when one of its suppliers suggested a commercial bagel mix that provided more consistent results. *RP vol. II, pp. 181.* Bagelheads has not used any of Kosterow's

recipes in its store since the year 2000. *RP vol. II, p. 181.* Because the restaurant switched to a commercial mix for its bagels, the cooking and preparation of the bagels is also different than it was when Bagelheads was using Kosterow's recipes. *RP vol. II, p. 182.*

In the summer of 2000, Bagelheads hired the George S. Maye Company, a small business consulting firm from Chicago, to come into its operations and to provide its own assessment and recommendations. *RP vol. II, p.182.* The company performed a front-to-back review of the operations. The result was a manual consisting of more than 100 pages that provided information and ideas to Bagelheads about costing and inventory control. *RP vol. II, p. 183; Ex. 60.* The consultants from the George S. Maye Company provided Bagelheads with everything from employee manuals to C.E.O. manuals to waste management information, and covered the store from front to back. *RP vol. II, pp. 184; Ex. 60.*

Eventually, Bagelheads succeeded to the point that others began to inquire about opening Bagelheads restaurants. In the spring of 2001, Bagelheads entered into a licensing agreement with Kevin Freeland, one of Robert Mackey's friends, under which Freeland would have the right to use the Bagelheads name and menu for a store that he opened on Nine Mile Road in Pensacola ("the Nine Mile Road store"). *RP vol. II, pp. 80-82, 186-187; Ex. 48.* Neither Robert Mackey nor Bagelheads had any

ownership interest in the Nine Mile Road store. *RP vol. II, p. 82.* Similar arrangements were established for Bagelheads restaurants in Fort Walton Beach, Florida, Tallahassee, Florida, and Pensacola Beach, Florida, and the owners of these stores also signed licensing and consulting agreements with Bagelheads. *RP vol. II, pp. 89-90, 103-105, 185; Exs. 39, 40, 48, 49.*

The Nine Mile Road, Fort Walton Beach, and Pensacola Beach stores used bagels prepared daily by Bagelheads at its downtown Pensacola location. Those stores have never made their own bagel dough, and Bagelheads has never disclosed to these store owners its own bagel recipes, much less Kosterow's recipes. *RP vol. II, pp. 113, 188-90, 201.* Mackey did not provide any financial or other information to these stores that he received from Kosterow. *RP vol. II, p. 192.* Instead, he used his own experience from his years operating the original Bagelheads store and the information he had learned from the George S. Maye Company to assist these new licensed restaurants. *RP vol. II, pp. 189-92.* The owners of the Fort Walton Beach restaurant had considerable experience in the restaurant business and did not ask for or receive any assistance from Mackey other than the raw bagels and cream cheese. *RP vol. II, pp. 196-97.* The Tallahassee store only licensed the Bagelheads name and has never used Bagelheads bagels or products or received any consulting services from Mackey. *RP vol. II, pp. 198-99.*

Because the Pensacola Beach store was experiencing financial difficulties, Robert Mackey formed a limited liability company for the purpose of purchasing a portion of the Pensacola Beach store from its owner. *RP vol. II, pp. 199-200*. Eventually, the limited liability company purchased 50.5% of the interest in the Pensacola Beach store. *RP vol. II, p. 200*. Mackey selected 50.5% as his ownership share because he did not want to owe Kosterow royalties for the store, since he had not used Kosterow's recipes or information in his stores in several years. *RP vol. II, p. 200*.

Bagelheads was admittedly slow to pay Kosterow the amounts owed to him under the consulting agreement. *RP vol. I, pp. 164-181*. Over time, however, Bagelheads paid Kosterow \$51,441.02 in royalties due under the consulting agreement. *RP vol. II, pp. 204-205*. Bagelheads acknowledged that the amount it had paid was an underpayment, but eventually determined that the exact amount still owed was less than \$1,000. *RP vol. II, p. 205*. Bagelheads continued to make periodic royalty payments to Kosterow even though it was no longer using his recipes in its operation and even though Bagelheads had retained a new consultant to perform an in-depth evaluation of its business.

III. Procedural History

Kosterow filed suit against Bagelheads, Robert Mackey, and Janet Mackey on July 28, 2004. *CP 1-11*. The complaint contained claims for breach of contract, violation of Florida's version of the Uniform Trade Secrets Act, and fraud. *CP 1-11*. The trial court granted the Mackeys' motion for partial summary judgment, agreeing that the claim for unpaid royalties should be directed solely to Bagelheads, not the Mackeys individually. *CP 71-83; 94-95*. Prior to trial, Kosterow dropped his fraud claim. *CP 524*. Thus, the case proceeded to trial on Kosterow's breach of contract claim for additional royalties against Bagelheads, his breach of contract claim alleging violation of the non-disclosure provision by all three defendants, and the statutory claim for misappropriation of trade secrets against all three defendants.

The jury trial took place over three days between September 11, 2006, and September 13, 2006. *CP 523*. Kosterow relied exclusively on testimony from himself and Robert Mackey to present his case. Kosterow testified that he was underpaid by Bagelheads and described the various types of information that he had provided to the Mackeys and Bagelheads under the consulting agreement. *RP vol. I, pp. 147-151; 158-180*. He offered no testimony concerning specific information that he believed Bagelheads or the Mackeys had disclosed to third parties, nor did he

introduce testimony from any of the owners of these other stores, much less their employees, customers, or suppliers.

During his testimony, Mackey vehemently denied providing any information that he had obtained from Kosterow to any of the other Bagelheads stores. *RP vol. II, p. 189, 192, 194, 200*. In fact, Mackey testified that the Tallahassee store licensed only the Bagelheads name and that the other three Bagelheads licensees obtained their bagels each day from the original Bagelheads store, and, therefore, never used a bagel recipe from any source. *RP vol. II, pp. 188-89, 195, 200*. Mackey further testified that Bagelheads had not used any of Kosterow's recipes since at least 2000 and that the assistance he provided to the other Bagelheads stores was limited to information that he had learned by operating his own Bagelheads restaurant for several years. *RP vol. II, pp. 181-82, 189-92*.

The jury returned a split verdict. *CP 432-34*. First, the jury returned a verdict against Bagelheads in the amount of \$994.49 for underpaying the royalties for the original store, which represented the exact amount that Mackey conceded he owed Kosterow on that claim. *RP vol. III, pp. 116-118*. Second, the jury held that Bagelheads had violated the consulting agreement by failing to pay royalties for the Pensacola Beach store and awarded \$24,000 in damages for that breach. Third, the jury held that both Bagelheads and Robert Mackey had violated the non-

disclosure provision in the contract and awarded \$27,200 for that breach. Fourth, the jury absolved Janet Mackey of any liability for breach of the non-disclosure provision. Finally, the jury rendered a defense verdict on the statutory cause of action for misappropriation of trade secrets. *CP 432-34.*

Kosterow filed a motion for costs and attorney's fees under the attorney's fee provision in the consulting agreement. Kosterow sought an award of \$55,773 in costs and attorney's fees. *CP 435-446, 524.* The trial court reduced that claim by 28% due to the defendants' victory on the trade secrets and fraud claims, and Janet Mackey's victory on the breach of contract claim. *CP 525.* Thus, the trial court awarded \$39,600 in attorney's fees to go along with the \$52,194.49 in damages awarded by the jury. *CP 528-534.*

The trial court entered judgment against Bagelheads and Mackey in the amount of \$91,794.49 on December 15, 2006. *CP 528-534.* This appeal followed.

SUMMARY OF ARGUMENT

The final judgment should be reversed because the jury's verdict was based upon no more than conjecture and speculation, not substantial evidence.

First, the portion of the judgment awarding Kosterow royalties for the Pensacola Beach store is contrary to the unambiguous language in the consulting agreement. Under the agreement, Bagelheads was required to pay royalties only on branches “in which Robert Mackey, Jr. owns no less than fifty-one percent (51%).” It is undisputed that Mackey owned just 50.5 percent of the Pensacola Beach store. Fifty-one percent means 51 percent, no more no less. Because the language is clear, and because Kosterow introduced no evidence suggesting that the parties intended 51 percent to mean anything else, the portion of the judgment awarding \$24,000 in royalties from the Pensacola Beach store should be reversed.

Second, the jury’s verdict that Mackey and Bagelheads breached the contract’s non-disclosure provision was not supported by substantial evidence. To prove that Mackey disclosed information provided by Kosterow, Kosterow was required to introduce evidence from which a jury could reasonably infer disclosure. But Kosterow introduced no evidence about the operations of any of the other Bagelheads restaurants, nor did he identify the information that Mackey allegedly disclosed to them. Instead, Kosterow asked the jury to presume that Mackey *must* have disclosed information to them—a presumption not permitted under the law. *RP vol. III, pp. 78-79*. Thus, the jury’s verdict rested on nothing more than conjecture and supposition.

Third, even assuming the jury properly determined that Mackey and Bagelheads had disclosed Kosterow's information to third parties, the jury's award of \$27,200 in damages for this breach of contract was not supported by substantial evidence. Damages for breach of contract are designed to place the non-breaching party in the same position he would have been in had the contract been performed. Kosterow offered no evidence that he had sustained a single dollar of damages from the alleged disclosure by Mackey. Instead, the jury based its damage award on the amount of royalties Kosterow would have received from the other stores—*assuming* he had been entitled to royalties from these stores. This was an impermissible basis for the award. It is undisputed that Kosterow would not have received these royalties had the contract been performed. The jury's damages award impermissibly placed Kosterow in a better position than he would have been in had the contract been performed.

Finally, assuming this Court reverses on any of the points raised in this appeal, the award of attorneys' fees and costs by the trial court under the consulting agreement should also be remanded to the trial court to reassess the prevailing party in the litigation. Further, in the event of a reversal, the Court should award Mackey and Bagelheads their attorneys' fees and costs as prevailing parties in this appeal.

ARGUMENT

I. The Trial Court Erred When It Entered Judgment For Kosterow On His Claim For Royalties From The Pensacola Beach Store.

This Court must reverse the award of \$24,000 in royalties on the Pensacola Beach store. Based on the unambiguous language in the contract, Bagelheads only owed royalties on stores in which Robert Mackey owned “no less than fifty-one percent (51%).” It is undisputed that Mackey owned just 50.5 percent of the Pensacola Beach store. As explained below, the issue should never have been submitted to the jury in the first place. If the submission to the jury was proper, there was no substantial evidence to support the verdict.

A. As A Matter Of Law, The Contract Did Not Entitle Kosterow To Royalties From The Pensacola Beach Store.

The contract establishes that Mackey did not owe royalties on the Pensacola Beach store.

1. This Court reviews the interpretation of an unambiguous written contract de novo.

This Court reviews issues of law, including the interpretation of unambiguous contracts, de novo. See QFC v. Mary Jewell T., LLC, 134 Wn. App. 814, 817, 142 P.3d 206 (2006). Because unambiguous contracts should be construed by the court as a matter of law, a trial court errs when

it submits an unambiguous contract to the jury for its own interpretation. See Jones v. Shell Oil Co., 164 Wash. 543, 550, 3 P.2d 141 (1931).

The consulting agreement contained a choice of law provision holding that it was to be interpreted under Florida law, and the parties agree that Florida law controls. *CP 1-11; 136; RP vol. III, pp 35, 41; Ex. 21, p. 3*. Under Florida law, when the language in a written contract is unambiguous, the intent of the parties must be determined solely from the four corners of the contract, and extrinsic or parol evidence is not permitted. See V & M Erectors, Inc. v. Middlesex Corp., 867 So. 2d 1252, 1253-54 (Fla. Dist. Ct. App. 2004); Burns v. Barfield, 732 So. 2d 1202, 1205 (Fla. Dist. Ct. App. 1999). The language used by the parties is the best evidence of intent, and the plain meaning of that language controls. Id. That one of the parties to the contract may have intended a different meaning is irrelevant if that meaning is inconsistent with the unambiguous contract language. See Bryant v. State Bd. of Regents, 596 So. 2d 1233 (Fla. Dist. Ct. App. 1992).¹

Thus, this issue presented a triable question of fact for the jury only if the language of the contract was somehow ambiguous. It was not.

¹ The same result would be reached under Washington law. See U.S. Credit Life Ins. Co. v. Williams, 129 Wn.2d 565, 569-71, 919 P.2d 594 (1996) (explaining that extrinsic evidence cannot be used to vary the terms of a written contract).

2. Fifty-one percent means fifty-one percent

The language in the compensation provision of the consulting agreement could scarcely be clearer. It states:

As compensation for its independent contractor services and for the disclosure and use of such recipes, formulas, methods, techniques, supplier information, etc., the Corporation shall pay to Consultant 2% of the Corporation's gross sales from each bagel store location owned by Bagelheads, Inc., owned by family members of Robert Mackey, Jr., or a branch in which Robert Mackey, Jr. owns no less than fifty-one percent (51%), arising from the sale of its bagel and related products for the initial four (4) year period of each bagel store location operation.

Ex. 21, p. 2 (emphasis added). The underlined section is subject to only one possible meaning: for Bagelheads to owe royalties on a branch it does not own (and that is not owned by a family member of Robert Mackey, Jr.), Robert Mackey must own at least 51 percent of the store. Fifty-one percent means 51 percent—nothing more, nothing less. Indeed, the parties emphasized that point by including the phrase “no less than” before the percentage and by identifying 51 percent both in text and numerical form.

It is undisputed that Robert Mackey, Jr. owned just 50.5 percent of the Pensacola Beach store, which is undeniably less than the 51 percent required for royalties to become due. *RP vol. II, pp. 106-07.* As a matter of elementary contract interpretation, Bagelheads did not owe royalties for the Pensacola Beach store.

The only argument advanced by Kosterow's attorney at trial to justify his request for royalties from the Pensacola Beach store was that the phrase "51 percent" in the contract was synonymous with "majority ownership." *RP vol. III, p. 69*. But it is not. Had the parties intended for royalties to become due on any branch in which Robert Mackey, Jr. owned a majority interest, they could have said so by using language such as "majority interest" or "more than 50 percent." That is not the language they chose, however. Instead, after several months of arms-length negotiations through counsel, they decided to use the phrase "no less than fifty-one percent"—a clear and unambiguous phrase that means what it says.

Kosterow's counsel acknowledged that Bagelheads would not owe royalties under the plain language of the contract when he questioned Robert Mackey as follows:

Q. Okay. So it was your idea for it to be 50.5% and you knew that under your consulting agreement with Mr. Kosterow that if your ownership was 51% or greater you were gonna have to pay Mr. Kosterow 2% of the sales for that Pensacola Beach store, right?

A. Correct.

Q. Okay. And so you kept your ownership just below the 51% level called for in the contract with Mr. Kosterow, right?

A. Yes.

RP vol. II, pp. 106-07.

The contract was unambiguous. Bagelheads did not owe royalties for the Pensacola Beach store under the contract language chosen by the parties. The portion of the judgment awarding royalties on that store cannot stand as a matter of law. The judgment should be reversed.

B. The Verdict Awarding Royalties From the Pensacola Beach Store Was Not Supported By Substantial Evidence.

If this Court determines that the issue of contract interpretation was properly submitted to the jury, the judgment should still be reversed.

1. A jury's verdict must be supported by substantial evidence to be sustained on appeal.

The award of royalties on the Pensacola Beach store was not supported by substantial evidence. Under Washington law, a jury's verdict may be overturned when it is clearly unsupported by substantial evidence. See Herring v. Dep't of Social and Health Serv., 81 Wn. App. 1, 15-16, 914 P.2d 67, 76-77 (1996). The substantial evidence requirement "necessitates that the evidence be such that it would convince "an unprejudiced, thinking mind." Industrial Indem. Co. of the Northwest, Inc. v. Kallevig, 114 Wn.2d 907, 916, 792 P.2d 520 (1990) (quoting Hojem v. Kelly, 93 Wn.2d 143, 145, 606 P.2d 275 (1980)). On

appeal, the only inquiry is whether the evidence was sufficient to sustain the jury's verdict. Id. It was not.

2. Kosterow presented no evidence that 51 percent meant anything other than 51 percent.

Kosterow presented no evidence that the relevant language was in any way ambiguous. He also presented no evidence that 51 percent meant anything other than 51 percent.

Kosterow never testified that the parties had agreed that 51 percent really meant "a majority." *See RP vol. III, p. 69.* Kosterow never testified that he believed the contract term meant "a majority." Id. Although Kosterow's attorney argued at trial that it was "clear" 51 percent meant "majority ownership," *RP vol. III, p. 69, pp. 103-05*, no evidence supports this construction. Even if Kosterow *had* testified as to a unilateral understanding of the contract, that testimony would be insufficient to sustain the verdict on this point. See Bryant v. State Bd. of Regents, supra, 596 So. 2d at 1234 ("While appellee may have intended the result that it has argued, the language of the agreement between the parties does not admit of any such undisclosed mental intention"). See also Lynott v. Nat'l Union Fire Ins. Co., 123 Wn.2d 678, 684, 871 P.2d 146 (1994) ("Unilateral or subjective purposes and intentions about the meanings of what is written do not constitute evidence of the parties' intentions").

The undisputed evidence demonstrated that Robert Mackey, Jr., owned just 50.5 percent of the Pensacola Beach store. *RP vol. II, p. 106.* Any jury verdict finding that 50.5 percent was “no less than fifty-one percent (51%)” cannot be supported by substantial evidence.

Because “no less than fifty-one percent (51%)” means just that, the portion of the judgment awarding royalties on the Pensacola Beach store should be reversed.

II. The Verdict That Mackey Breached The Non-disclosure Clause Was Not Supported by Substantial Evidence.

The jury’s verdict that Mackey breached the non-disclosure clause was based on conjecture and supposition. No evidence supports a finding of disclosure. This portion of the verdict requires reversal.

A. Substantial Evidence Must Support The Jury’s Verdict That Mackey Breached The Non-disclosure Clause.

The evidence in this case cannot sustain the jury’s verdict that Mackey breached the non-disclosure clause. A jury’s verdict may be overturned when it is clearly unsupported by substantial evidence. See Herring v. Dep’t of Social and Health Serv., supra, 81 Wn. App. at 15-16.

Substantial evidence is "of a character which would convince an unprejudiced, thinking mind of the truth of the fact to which the evidence is directed"

Johnson v. Aluminum Precision Prod., 135 Wn. App. 204, 209, 143 P.3d 876 (2006). When applying the substantial evidence test, Washington courts have cautioned that “[a] verdict cannot be founded on mere theory or speculation.” Id. While circumstantial evidence may be used to meet the substantial evidence test, “[i]n applying the circumstantial evidence submitted to prove a fact, the trier of fact must recognize the distinction between that which is mere conjecture and what is a reasonable inference.” Callahan v. Keystone Fireworks Mfg. Co., 72 Wn.2d 823, 829, 435 P.2d 626 (1967) (quoting Gardner v. Seymour, 27 Wn.2d 802, 808-09, 180 P.2d 564 (1947)). The evidence presented at trial supports no reasonable inference that Mackey divulged information received from Kosterow regarding the bagel operation business.

B. Kosterow Failed To Present Any Evidence That Mackey Disclosed Information Received From Kosterow.

Kosterow failed to present evidence that Mackey breached the non-disclosure provision. To prove a claim for breach of contract under Florida law, Kosterow was required to prove: (1) a valid contract; (2) a material breach of the contract; and (3) damages from the breach. See Merin Hunter Codman, Inc. v. Wackenhut Corrections Corp., 941 So. 2d 396, 398 (Fla. Dist. Ct. App. 2006). Under the non-disclosure provision of the contract, a breach arises if Bagelheads or Mackey actually “divulged”

information obtained from Kosterow to third parties. *Ex. 21, p. 2*. Proof of possession of information is insufficient. To sustain the jury's verdict, Kosterow must point to substantial evidence in the record that Bagelheads or Mackey actually disclosed information provided by Kosterow to third parties. See General Steel Prod. Co. v. Lorenz, 204 F.Supp. 518, 539 (S.D. Fla. 1962) (holding that, to prevail on a claim for breach of confidential disclosure, a party must establish that the other party "used or disclosed the knowledge or information so obtained in violation of the confidence"), *aff'd* 337 F.2d 726 (5th Cir. 1964). Accord Sip-Top, Inc. v. Ekco Group, 86 F.3d 827, 831 (8th Cir. 1996).

Kosterow introduced no substantial evidence that Mackey disclosed *any* information to third parties.² The evidence required to sustain the verdict must provide some logical basis by which the jury could have reasonably inferred that Mackey provided Kosterow's

² The trial court incorrectly instructed the jury that disclosure of *any* information provided by Kosterow would qualify as a breach of contract. *RP vol. III, pp. 50, 62*. Under Florida law, only confidential information is entitled to legal protection. See AutoNation, Inc. v. O'Brien, 347 F.Supp.2d 1299, 1304 (S.D. Fla. 2004) ("[C]onfidential business information is considered a legitimate business interest that can be protected by a restrictive covenant in an employment contract. . . . However, information that is commonly known in the industry and not unique to the allegedly injured party is not confidential and is not entitled to protection.") Because Kosterow introduced no substantial evidence that Mackey disclosed *any* information to third parties—confidential or otherwise—the result is the same.

information to the owners of the other Bagelheads stores. Absent direct evidence of improper disclosure—which even Kosterow concedes he does not have—Kosterow was required to produce sufficient circumstantial evidence to support the verdict. *RP vol. III, pp. 78-79.*

At a minimum, this circumstantial evidence must prove that some aspect of the information provided by Kosterow actually made its way into the other restaurants. In the directly analogous context of trade-secret misappropriation, courts have consistently held that “[s]ufficient circumstantial evidence of use in trade-secret cases must demonstrate that (1) the misappropriating party had access to the secret and (2) the secret and the defendant’s design share similar features.” Stratienko v. Cordis Corp., 429 F.3d 592, 600 (6th Cir. 2005) (emphasis added). Federal courts analyzing claims of copyright infringement apply the same test. See Autoskill, Inc. v. Nat’l Educ. Support Sys., Inc., 793 F.Supp. 1557, 1563 (D.N.M. 1992) (holding that, to establish copyright infringement by circumstantial evidence, the plaintiff must prove both that the defendant had access to the copyright work and “the substantial similarity of defendant’s work to the copyrighted work”), *aff’d and remanded* 994 F.2d 1476 (10th Cir. 1993), *cert den.* 510 U.S. 916 (1993). Kosterow provided no such evidence upon which to base an inference that his information was ever relayed to third parties.

Kosterow offered no testimony from the owners of any of the other Bagelheads stores, nor did he introduce testimony from their employees, customers, or suppliers. He introduced no evidence that those stores used his bagel recipes or even that their bagels were made using the same techniques he had shown to Mackey. Kosterow offered no evidence that the owners of these stores had ever received any financial information that Kosterow had provided to Mackey. He introduced no menus, advertisements, or other documentary evidence in an effort to prove that the operations of these Bagelheads stores were substantially similar to his own. He offered no evidence to rebut Mackey's specific denials that he provided any information obtained from Kosterow to these restaurants. *RP vol. II, p. 189, 192, 194, 200.*

Kosterow did not rely upon evidence to support his breach of contract claim. Instead, Kosterow asked the jury to take a cynical leap of faith and to *assume* that Mackey provided these restaurants information that he had obtained from Kosterow. Kosterow attempted to prove his case using the following logic: (1) Mackey had obtained significant amounts of information from Kosterow, including his recipes; (2) three years after he obtained this information, Mackey helped these new restaurants become established in Florida; so therefore (3) Mackey *must* have provided information he had obtained from Kosterow to these new

restaurants. *RP vol. III, pp. 78-79*. That is the very type of conjecture and speculation that Washington courts have routinely rejected to support a jury's verdict. See Johnson v. Aluminum Precision Prod., Inc., *supra*, 135 Wn. App. at 209.

The decision from the Eighth Circuit Court of Appeals in Sip-Top, Inc. v. Ekco Group, *supra*, 86 F.3d 827, is especially instructive. In Sip-Top, the plaintiff had entered into negotiations with the defendant over a possible acquisition and required the defendant to sign a non-disclosure agreement. *Id.* at 829. After those negotiations ended and the defendant purchased a similar product from another manufacturer, the plaintiff filed suit. Plaintiff alleged breach of the non-disclosure agreement and related torts. In general, the plaintiff alleged that the defendant had used or disclosed the information defendant had received from the plaintiff during defendant's negotiations with the competitor ultimately selected. *Id.* at 830-31. At the close of the plaintiff's case before the jury, the district court directed a verdict in favor of the defendant on all counts, and the plaintiff appealed. *Id.* at 830.

The court of appeals affirmed the directed verdict, concluding that the plaintiff "failed to provide sufficient evidence to support a jury verdict that [the defendant] used, or divulged, any confidential information when it negotiated" with the competitor. Sip-Top, Inc. v. Ekco Group, *supra*, 86

F.3d at 831. As in this case, the plaintiff in Sip-Top argued that a jury question on breach of the non-disclosure agreement existed based on circumstantial evidence. The appellate court flatly rejected the argument, stating,

Sip-Top asserts that the jury should have been able to infer that in negotiating with Maverick, Ekco used or divulged confidential information provided by Sip-Top. This type of inference, however, is unreasonable and nothing more than mere speculation. And as such, it is insufficient to survive a motion for judgment as a matter of law.

Id. As the Eighth Circuit observed, “[t]o accept Sip-Top’s argument we would need to make the unreasonable inference that every time a company receives confidential information it uses that information if it negotiates with another entity.” Id.

A federal district court in Minnesota rejected a similarly unsupported claim for breach of a non-disclosure agreement. See Vision-Ease Lens, Inc. v. Essilor Int’l SA, 322 F.Supp. 2d 991 (D. Minn. 2004). In Vision-Ease, an eyeglass manufacturer sued a former supplier for breaching a confidentiality agreement after it began to manufacture a competing lens. Id. at 993-994. According to Vision-Ease, the defendant’s new lens used a type of mold face similar to that suggested by Vision-Ease during prior meetings and which was different than the prior

lenses manufactured by the defendant. Id. at 995. The district court disagreed that this was sufficient to meet its burden:

Vision-Ease has not demonstrated the *use* of that information. Vision-Ease's argument is based on a supposition. Because, it asserts, the mold face disposition of the Ovation lenses differs from Essilor's common practice . . . Essilor must have used the information disclosed to it by Vision-Ease. It is not enough, however, to "point to broad areas of technology and assert that something there must have been secret and misappropriated." Composite Marine Propellers, Inc. v. Van Der Woude, 962 F.2d 1263, 1266 (7th Cir. 1992). Vision-Ease must instead show actual use.

Id. at 995 (emphasis in original).

The facts of these cases only serve to highlight the utter emptiness of Kosterow's case. In Sip-Top, the court rejected the plaintiff's evidence as "mere speculation," even though in that case, it was undisputed that the competing products were similar in nature. Sip-Top, Inc. v. Ekco Group, supra, 86 F.3d at 831. In Vision-Ease, the court found the plaintiff's evidence to be "based on a supposition," even though the competing products were similar. Vision-Ease Lens, Inc. v. Essilor Int'l SA, supra, 322 F. Supp. 2d at 995. In contrast, Kosterow offered *no evidence* that any of the other Bagelheads stores in Florida had adopted as their own any of the ideas or information he provided to Mackey.

The insufficiency of Kosterow's proof on this claim, however, goes deeper. Kosterow failed even to identify exactly what information he

believes Mackey disclosed in violation of the agreement. As the United States Court of Appeals for the Third Circuit observed in a similar situation, “Palm Bay’s failure is even more fundamental: to the extent that its claim is premised on disclosure of confidential business information, it cannot identify with any degree of specificity the information actually disclosed.” Palm Bay Imports, Inc. v. Miron, 55 Fed.Appx. 52, 57 (3d Cir. 2002) (affirming summary judgment dismissing the plaintiff’s claim for unlawful disclosure of confidential information). Kosterow’s claim suffers from this same fundamental failure. One could read the record of proceedings cover to cover without gleaning any insight into exactly what information Kosterow believes Mackey disclosed. Was it the recipes? The bagel-making techniques? The brand of flour he used in his operations? The location of his soap dispensers in the bathroom?

Kosterow’s failure to identify the information he believes Mackey disclosed is far from a technicality. Without any means of identifying exactly how Mackey allegedly violated the non-disclosure provision, it is impossible to determine whether the alleged breach was material, which is a fundamental requirement to recover breach of contract damages under Florida law. See Merin Hunter Codman, Inc. v. Wackenhut Corrections Corp., supra, 941 So. 2d at 398 (elements of a breach of contract claim include “a material breach”).

Ultimately, Kosterow apparently convinced the jury to take the leap of faith with him and find that Mackey must have disclosed some unidentified information to at least one unidentified third party. Given the lack of evidence to support the verdict, however, it rests on no more than conjecture and supposition. This portion of the judgment must be reversed.

III. The Award Of Damages For Violation Of The Non-disclosure Provision Was Not Supported By Substantial Evidence.

The damages awarded for the breach of the non-disclosure provision must be overturned. No evidence supports the award.

A. Damages For Breach Of Contract Must Place The Plaintiff In The Same Position As If There Had Been No Breach.

The damages awarded for the breach of the non-disclosure provision are unsupported by Florida (and Washington) law. Under Florida law, “[t]he purpose of compensation for a breach of contract is to place the injured party in the position it would have been had the breach not occurred.” Home Ins. Co. v. Crawford & Co., 890 So. 2d 1186, 1189 (Fla. Dist. Ct. App. 2005). Accord Telemundo Network, Inc. v. Spanish Television Serv., Inc., 812 So. 2d 461, 464 (Fla. Dist. Ct. App. 2002).³

³ Washington law follows a similar rule. See Mason v. Mortgage America, Inc., 114 Wn. 2d 842, 849, note 6, 792 P. 2d 142 (1990).

See also *RP vol. III, pp. 52-53* (trial court instructing on damages); *CP 404-407* (jury instructions). Ordinarily, damages for violating a non-disclosure provision would include items such as lost sales or lost profits. See *Camel Invest. v. Webber*, 468 So. 2d 340, 342 (Fla. Dist. Ct. App. 1985). See also *American Maplan Corp. v. Heilmayr*, 165 F.Supp.2d 1247, 1253 (D. Kan. 2001) (“[P]laintiff still has not directed the court to any evidence that it has lost customers or sales to VET or, more importantly, that it has lost customers or sales to VET based on defendant's knowledge of or disclosure of plaintiff's pricing information.”] It was incumbent upon Kosterow to prove the actual damages that he sustained from the alleged disclosures. This he did not do.

B. Kosterow Failed To Offer Any Evidence That He Had Sustained Any Damages From The Alleged Disclosures.

Kosterow introduced no evidence whatsoever that he sustained any damages from the alleged breach of the non-disclosure agreement. He offered no testimony that his business sustained any lost profits or that he lost a single customer as a result of the alleged disclosure. Kosterow identified no decrease in the value of his business information, nor did he offer evidence that the information had been used to his detriment. And since Kosterow introduced no evidence identifying exactly what information he believes was disclosed, putting a dollar figure on the loss

necessarily requires speculation. The damage award cannot be sustained by the evidence.

Rather than focusing on the harm caused to Kosterow by the alleged disclosure, the jury apparently accepted an invitation from Kosterow's counsel during closing arguments to award Kosterow damages in the form of royalty payments from the other Bagelheads restaurants. *RP vol. III, pp. 103-05.*⁴ However, Kosterow was never entitled to receive royalty payments from the other Bagelheads stores and would not have been entitled to royalties even if the contract had been fully performed, i.e. if no information had been disclosed. Royalty payments was an impermissible basis for the damage award.

By awarding Kosterow a percentage of the sales from the other Bagelheads stores, the jury's damage award placed Kosterow in a better position than he would have been in had the contract been fully performed. This windfall is contrary to Florida law.

At most, Kosterow was entitled to nominal damages for breach of the non-disclosure provision in the absence of proof that he sustained actual damages. See Indian River Colony Club, Inc. v. Schopke Constr. &

⁴ While it is not clear how the jury arrived at the exact figure awarded of \$27,200, the royalties approach was the only damages approach suggested by Kosterow's attorney in closing. This further illustrates that Kosterow provided the jury with no evidence on which to properly award damages.

Eng'g, Inc., 619 So. 2d 6, 8 (Fla. Dist. Ct. App. 1993). See also Shields v. DeVries, 70 Wn.2d 296, 301, 422 P.2d 828 (1967) (“certainly no more than nominal damages can be predicated on the failure to keep a promise which, had it been kept, would not have benefited the plaintiffs in any way”). Even if the evidence supported a finding of liability for breach of the non-disclosure agreement, the award of damages for the breach should be reversed for lack of evidence.

IV. If The Court Reverses The Judgment On Any Basis, The Award Of Fees And Costs Should Be Vacated And Remanded.

The trial court below entered an award of attorney’s fees and costs in favor of Kosterow in the amount of \$39,600 under a provision in the consulting agreement providing that “the prevailing party shall be entitled to recover [] all costs and expenses incurred in settling the controversy, including, but not limited to, all attorneys’ fees of every kind, whether incurred by suit or otherwise.” *CP 524-25; ex. 21, p. 4*. To arrive at the amount of fees and costs, the trial court reduced the amount claimed by 28% to reflect that the defendants below prevailed on several key issues. *CP 525*. See Phillips Bldg. Co., Inc. v. An, 81 Wn. App. 696, 702, 915 P.2d 1146 (1996) (discussing proportionality approach for awarding fees when a party prevails on some, but not all, of its claims).

Here, assuming the Court reverses on even one of the points raised in this appeal, the trial court's determination of the prevailing party below—as well as its allocation of success under the proportionality test—will necessarily need to be reexamined. For example, if this Court were to reverse on all points raised in this appeal, Bagelheads and Mackey would certainly be the prevailing party. Even if it reversed on just one point, the same would still hold true, as Bagelheads and Mackey would have prevailed on the majority of issues raised by the complaint. Thus, this Court should also vacate the award of attorney's fees and remand that matter back to the trial court for reconsideration. See Beers v. Ross, 137 Wn. App. 566, 575, 154 P.3d 277 (2007) (vacating award of fees and costs entered by trial court in light of reversal of underlying judgment).

V. Bagelheads And Mackey Are Entitled To An Award Of Costs And Attorney's Fees If They Prevail In This Appeal.

As demonstrated above, the consulting agreement entered into between the parties provided for an award of attorney's fees to the prevailing party. *Ex. 21 p. 4*. Bagelheads and Mackey request the Court award them reasonable costs and attorney's fees for prosecuting this appeal if they prevail.

Because the parties stipulated in their contract that it would be governed by Florida law, the determination of which party is entitled to

recover attorney's fees under the contract would also be determined by Florida law. *Ex. 21, p. 3*. Under Florida law, the prevailing party for purposes of a contractual attorney's fee award is the party that prevailed on the "significant issues" before the court. See Moritz v. Hoyt Enters., Inc., 604 So. 2d 807, 810 (Fla. 1992). Florida courts apply the same test for determining whether a party is entitled to attorney's fees on appeal. See North Am. Van Lines, Inc. v. Ferguson Transp., 662 So. 2d 1275 (Fla. Dist. Ct. App. 1995).

Assuming the Court reverses the judgment below in any respect, Bagelheads and Mackey will be the prevailing parties under the contract for purposes of this appeal. This is true even if they prevail only on one of the issues raised above. That victory—coupled with the necessary remand of the attorneys' fee award—would render them the prevailing parties under any analysis. See North Am. Van Lines, *supra*, 662 So. 2d at 1275.

CONCLUSION

This is one of those thankfully rare situations in which the jury simply got it wrong on the evidence presented. The portion of the judgment awarding Kosterow royalties on the Pensacola Beach store should be reversed because the contract provides that Bagelheads does not owe royalties on that store. The portion of the judgment awarding damages for breach of the non-disclosure provision should be reversed

because the verdict was based on nothing more than conjecture and supposition. Finally, the award of attorneys' fees and costs should also be reversed and remanded for reassessment in light of this Court's ruling.

Respectfully submitted this 21st day of May, 2007.



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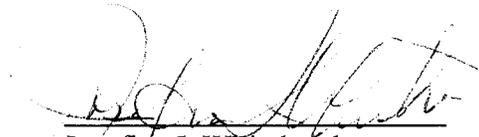
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I hereby certify that on the 29th day of May 2007, I caused to be served by hand delivery the foregoing Brief of Appellants Bagelheads, Inc. and Robert Mackey, Jr. on the following:

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