NO. 39853-2-II

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

DRAGON FIRE INVESTMENTS, LLC, *et al.*,

Appellants,

vs.

HIT ENTERPRISES, LLC, *et al.*,

Respondents,

APPEAL FROM THE SUPERIOR COURT

HONORABLE ROBERT L. HARRIS

BRIEF OF RESPONDENTS

BEN SHAFTON
Attorney for Defendants/Respondents
Caron, Colven, Robison & Shafton
900 Washington Street, Suite 1000
Vancouver, WA 98660
(360) 699-3001

Table of Contents

RESPONSE TO ASSIGNMENTS OF ERROR 1

STATEMENT OF THE CASE 2

I. The Participants. 2

II. Sale of Business. 2

III. Restaurant Operations. 4

IV. Communications from Kahala. 6

V. Course of Proceedings. 7

ARGUMENT 9

I. Standard of Review. 9

II. The Trial Court Correctly Determined that Hit Did Not Sell a Kahala Franchise to the Thorbeckes. 10

a. Introduction. 10

b. Rules for Interpretation of Contracts 10

c. The Language of the Contract Cannot Be Interpreted to Conclude That Hit Sold a Franchise. 13

d. Extrinsic Evidence Cannot Be Considered. 17

e. Even if Considered, the Extrinsic Evidence Supports the Conclusion that Hit Did Not Sell the Kahala Franchise. 18

f. The Extrinsic Evidence on Which the Thorbeckes Rely Is Otherwise Inadmissible 19

i. Evidence of Value of the Equipment Is Not Admissible. 19

ii. Evidence of the Thorbeckes' Intentions Is Inadmissible. 20

iii. Conclusion. 21

g. Conclusion.......... 21

IV. The Thorbeckes Are Not Entitled to Relief under the Franchise Investment Protection Act.......... 22

V. The Thorbeckes Sought No Other Relief.......... 28

STATEMENT REQUIRED BY RAP 18.1 31

CONCLUSION.......... 32

Table of Authorities

Cases

Adler v. Fred Lind Manor, 153 Wn.2d 331, 351-2, 103 P.3d 773 (2004) ..11

Berg v. Hudesman, 115 Wn.2d 657, 663, 801 P.2d 222 (1990) 11

Berg v. Settle, 70 Wn.2d 864, 425 P.2d 635 (1967) 16

Busch v. Nervik, 38 Wn.App. 541,549, 687 P.2d 872 (1984)..................... 31

Columbia CU Committee v. Columbia Credit Union, 134 Wn.App. 175, 181, 139 P.3d 386 (2006) 10

Cook v. Vennigerholz, 44 Wn.2d 612, 616-17, 269 P.2d 824 (1954) 15

Cowiche Canyon Conservancy v. Bosley, 118 Wn.2d 801, 809, 828 P.2d 549 (1992) 29, 30

Dale v. Black, 81 Wn.App. 599, 915 P.2d 1116 (1996) 26

Drake v. Maid-Rite Co., 681 N.E.2d 734 (Ind.App. 1997) 27

Dwelley v. Chesterfield, 88 Wn.2d 331, 560 P.2d 353 (1977) 12, 19, 20

Federal Finance Co. v. Humiston, 66 Wn.2d 648, 651, 404 P.2d 465 91965) 15

Folsom v. Burger King, 135 Wn.2d 658, 663, 958 P.2d 301 (1998)........... 9

Forest Marketing Enterprises v. State, Dept. of Natural Resources, 125 Wn.App. 126, 104 P.3d 40 (2005) 12

Hearst Communications, Inc., v. Seattle Times Company, 154 Wn.2d 493, 504, 115 P.3d 262 (2005) 11

Hendrickson v. King County, 101 Wn.App. 258, 266, 2 P.3d 1006 (2000) 28

Hessler Construction Co. Inc., v. Looney, 52 Wn.App. 110, 113, 757 P.2d 988 (1988) ... 31

Hollis v. Garwall, 137 Wn.2d 683, 695-96, 974 P.2d 836 (1999) 11, 12, 17, 19, 20

Lilly v. Lynch, 88 Wn.App. 306, 320-21, 945 P.2d 727 (1997) ... 30

Mountain Park Homeowners Association, Inc. v. Tydings, 125 Wn.2d 337, 344, 883, P.2d 1383 (1994) ... 28

Northern State Construction Co. v Robbins, 76 Wn.2d 357, 365 457 P.2d 187(1969) ... 15

Olympia Police Guild v. City of Olympia, 60 Wn.App. 556, 805 P.2d 245 (1991) ... 12, 19, 20

Olympic Pipeline Company v. Thoeny, 124 Wn.App. 381, 440 fn. 20, 101 P.3d 430 (2004) ... 30

Perry v. Moran, 109 Wn.2d 691, 705, 748 P.2d 224 (1987) ... 31

Pollock v. Ralston, 5 Wn.2d 36, 44, 104 P.2d 934 (1940) ... 16

Roberts, Jackson & Associates, v. Pier 66 Corporation, 41 Wn.App. 64, 702 P.2d 137 (1985) ... 12

Snap-On Tools Corp. v. Roberts 35 Wn.App. 32, 665 P.2d 417 (1983) ... 20

Tanner Electric Cooperative v. Puget Sound Power & Light Co., 128 Wn.2d 676, 674, 911 P.2d 1301 (1998) ... 10

Thompson v. Lennox, 151 Wn.App. 479,491, 212 P.3d 597 (2009) ... 32

Vallandigham v. Clover Park School District No. 400, 154 Wn.2d 16, 26, 109 P.3d 805 (2005) ... 9

Washington Imaging Services, LLC, v. Washington State Department of Revenue, 153 Wn.App. 281, 287-88, 222 P.3d 801 (2009) ... 9

Watkins v. Restorative Care Center, Inc., 66 Wn.App. 178, 831 P.2d 1085 (1992) 12

West v. Thurston County, 144 Wn.App. 573, 580, 183 P.3d 346 (2008) ... 29

Statutes

RCW 19.100 ..... 1, 7, 24, 27, 30, 31, 36

RCW 19.100.010(10) 27

RCW 19.100.010(2) 28

RCW 19.100.010(8) 27

RCW 19.100.010(9) 27

RCW 19.100.020(1) 25, 27

RCW 19.100.030(1) 28, 29, 30

RCW 19.100.040 25

RCW 19.100.080 25

RCW 19.100.190 ..... 8, 24

RCW 19.100.190(2) 26

RCW 19.100.190(5) 24

RCW 19.86 24

Other Authorities

*Balck's Law Dictionary (*8th Ed. 2004) 24

Chisum *State Regulation of Franchising: The Washington Experience,* 48 Wash.L.Rev. 291, 347-48 *fn.* 285 (1973) 26

Ind.Code § 23-2-2.5-4 26

Rules

CR 56(d) ... 10

CR 56(e) ... 17

CR56(e) ... 21

RAP 12.8 ... 30

RAP 18.1(a) ... 31

RAP 2.5(a) ... 29

RESPONSE TO ASSIGNMENTS OF ERROR

William and Regina Thorbecke and Dragon Fire Investments, LLC (collectively the Thorbeckes) have not specifically assigned error to any order the trial court entered. Hit Enterprises, LLC and Thomas and Heidi Klutz (collectively Hit) must guess as to exactly which orders the Thorbeckes claim were erroneously made. As near as Hit can tell, these would be the Order on Motion for Summary Judgment entered June 12, 2009, and the Judgment entered September 17, 2009. (CP 526-28; CP 555-57) Mr. Klutz believes that the trial court did not err in entering these two orders.

Mr. Klutz submits the following as issues for appeal:

1. Did the trial court properly conclude that Hit Enterprises, LLC, did not transfer its franchise with Kahala Franchise Corporation (Kahala) to the Thorbeckes or any of them?

2. Is the sale exempt from the registration requirements of RCW 19.100?

///

STATEMENT OF THE CASE

I. The Participants.

In May of 1999, Kahala Franchise Corp. (Kahala) granted a franchise to Hit for the operation of a Samurai Sam's restaurant located at 1401 SE 164th Avenue, #150, Vancouver, Washington. (CP 58-103) Kyle Leonard worked for Hit and ultimately rose to the position of store manager. He later went to work as a trainer for Kahala. (CP 363, CP 438-39)

Mr. Leonard is the son of Regina Norby-Thorbecke and the stepson of William Thorbecke. (CP 358)

II. Sale of Business.

In 2005, Mr. Leonard learned that Hit was interested in selling the Samurai Sam's restaurant. He approached Mr. Thorbecke and stated that he was knowledgeable concerning the operations of a Samurai Sam's restaurant and could manage the business successfully. Mr. Thorbecke wanted to provide Mr. Leonard with an opportunity to "capitalize on his strengths and talents," and indicated that he would help Mr. Leonard with the capital necessary to purchase the restaurant. (CP 362-63)

The Thorbeckes then began discussing the proposed transaction with Mr. Klutz on behalf of Hit. Mr. Klutz provided them with profit and loss statements for the business for the years 2003 and 2004 and for

January through August of 2005. He also gave them a copy of the franchise agreement with Kahala. (CP 343) The Thorbeckes reviewed the financial documents as much as they desired and concede that these allowed them to determine the restaurant's profitability. Excluding depreciation, the restaurant had net income of $18,514.00 in 2003; $14,314.00 in 2004; and $22,532.00 in the first eight months of 2005. The net income shown on the profit and loss statements also did not reflect any debt service that might be incurred, for example, for a loan for the purchase of the business. (CP 367, 453, 455-61)

Mr. Leonard advised the Thorbeckes that the Samurai Sam's restaurant was a franchise. (CP 364, 449-50) The Thorbeckes were also aware that franchise royalties would have to be paid to Kahala. (CP 366)

The parties discussed transferring the franchise to the Thorbeckes as part of the sale of the business. The franchise agreement allowed for such a transfer upon, among other things, the payment of a $5,000.00 transfer fee. (CP 80-81) The Thorbeckes were not interested in paying such a fee. (CP 343) The parties then agreed to enter into an alternate arrangement they referred to as "subcontracting." The Thorbeckes would operate the restaurant under Hit's franchise agreement with Kahala. The "subcontracting" would obviate the necessity of paying a transfer fee. (CP 343, 372, 449-51)

The parties agreed on a purchase price of $170,000.00 with $60,000.00 to be paid down and the remainder on a promissory note. Hit had sought a larger down payment. The Thorbeckes declined stating that $60,000.00 was the limit of the cash they had on hand to devote to the purchase. (CP 343, CP 363)

The parties executed several documents on November 16, 2005. These included the Agreement to Sell Business; Schedule A, entitled Asset Listing; an Addendum to purchase agreement; an amortization schedule for payments on the promissory note for payment of the balance of the purchase price; a Bill of Sale; and a promissory note. (CP 408-416; CP 533-34) The Agreement to Sell Business indicates that the Thorbeckes were paying $170,000.00 for certain assets; that they were making a down payment of $60,000.00; and that the remainder would be paid on the basis of the promissory note. The promissory note showed a principal balance of $110,000.000; interest at 7.5% per annum; and a due date for all principal and interests payments in 2010. It required monthly payments of $2.204.17. The specific terms of these agreements will be discussed in more detail in the "Argument" section of this brief.

III. <u>Restaurant Operations</u>.

Mr. and Mrs. Thorbecke loaned $30,000.00 to Mr. Leonard for his share of the down payment. (CP 405) The three then formed Dragon Fire

Investments, LLC on November 18, 2005. (CP 403) They executed an Operating Agreement that created a division of labor between them. Mr. Leonard was to handle all day-to-day operations while Mr. and Mrs. Thorbecke dealt with the books. Any profits would be split evenly between Mr. Leonard on the one hand and Mr. and Mrs. Thorbecke on the other. Interestingly, Mr. Klutz was made a part owner of the company. His financial benefit from doing so was limited to free dining. (CP 359, 404-5)

Mr. Leonard took responsibility for restaurant operations while Mr. Thorbecke dealt with the financial issues and the payment of bills. (CP 360) Mr. Klutz provided assistance on operational, marketing, and accounting issues. He was available as needed for consultation. (CP 361-62, 365, 448) Kahala received franchise royalties after the sale. The Thorbeckes paid the appropriate amount to Mr. Klutz who would then forward that sum to Kahala. (CP 366)

The restaurant's operation did not go well. The profit and loss statements from the business show a net loss of $22,053.00 exclusive of any debt service on the purchase price to Mr. Klutz. (CP 462-488)

Mr. Thorbecke became frustrated with Mr. Leonard's performance as a store manager. (CP 344, 371) The restaurant's financial difficulties caused Kahala to agree to defer royalty payments during the later part of 2006 and early 2007. (CP 370, 441)

Mr. Leonard could not repay his loan to Mr. and Mrs. Thorbecke. As a result, he withdrew from Dragon Fire Investments, LLC in exchange for forgiveness of his loan. (CP 374, 406-7)

By March of 2007, the business was in deep difficulty. It was not operating at a profit, and Mr. Leonard had defaulted on his loan.

IV. Communications from Kahala.

On June 21, 2007, Kahala's attorney, Richard Anderson, wrote the Thorbeckes concerning the current operation and status of the business. Mr. Anderson wanted to know how Thorbeckes had come to operate the restaurant and indicated that there had been no approved transfer of the franchise. He invited the Thorbeckes to assume the status of franchisee. He stated:

> If you wish to commence the process to transfer the franchise agreement to Dragon Fire, LLC, please let me know immediately. Kahala reserves any and all rights it has under the franchise agreement to approve or not approve any transfer of the franchise agreement to Dragon Fire, LLC.

(CP 375-76) The Thorbeckes' attorney responded by letter dated July 9, 2007. He noted that the business had "struggled." He then stated:

> Therefore, you are hereby advised that Dragon Fire, LLC will discontinue the use of Samurai Sam's name, mark

> and logos. They will not set themselves out as a Samurai Sam's franchise and will immediately refurbish their location so that it does not in any way set its self out to represent a Samurai Sam's operation in any respect. . .

(CP 497-98) The Thorbeckes made that choice because they did not want to expend any additional monies to obtain a Kahala franchise. (CP 454) They ultimately closed the restaurant on February 28, 2008. (CP 369)

The Thorbeckes made their last payment on the promissory note with the payment due on July 23, 2007. (CP 530)

V. Course of Proceedings.

In April of 2007, Kahala sued Hit for breach of the franchise agreement. (CP 1-7) Hit filed a third-party claim against the Thorbeckes for failure to pay on the promissory note. (CP 112-15) The Thorbeckes responded. They alleged certain affirmative defenses. These included the alleged illegality of their contract with Hit; breach of contract; fraud; and violation of RCW 19.100, Washington's Franchise Investment Protection Act. They also set out two counterclaims. One alleged fraud on the part of Hit. The other claimed that Hit had sold a franchise to them in violation of the registration requirements of RCW 19.100. They sought all relief allowed by RCW 19.100.190. (CP 124-29)

In January of 2009, the Thorbeckes moved for partial summary judgment seeking a declaration that Hit had sold them a franchise; the sale had not effectively transferred the franchise to them; that they had been damaged; and that they should have no further duty to make further payments to Hit on the promissory note. (CP 302-4) On April 15, 2009, the trial court entered its Memorandum of Decision. (CP 523-25) It later confirmed its ruling in its Order on Motion for Summary Judgment entered June 12, 2009. In that order, the trial court denied the Thorbeckes' motion for summary judgment but determined that there was no genuine issue of material fact as to two propositions. First of all, it ruled that Hit had sold a business to the Thorbeckes by contract dated November 16, 2005. Secondly, it found that Hit did not transfer the franchise with Kahala to the Thorbeckes as part of the transaction. (CP 527)

Hit then moved for summary judgment on the promissory note. (CP 529-34) The Thorbeckes responded to the motion but did not allege that any common law fraud had been perpetrated upon them. (CP 535-40) The trial court granted Hit's summary judgment motion. (CP 549-50) It entered judgment in its favor against the Thorbeckes for the principal amount due and owing under the promissory note together with prejudgment interest and attorney's fees and costs. (CP 555-57) The Thorbeckes then appealed. (CP 558-75)

ARGUMENT

I. Standard of Review.

This is an appeal from a ruling on a motion for summary judgment. The Appellate Court reviews the grant or denial of such a motion *de novo* and engages in the same inquiry as does the trial court. Summary judgment is appropriate when there is no genuine issue of material fact. Furthermore, the Court must resolve all factual questions and inferences from the facts that are presented against the moving and in favor of the nonmoving party. *Folsom v. Burger King,* 135 Wn.2d 658, 663, 958 P.2d 301 (1998). Summary judgment is appropriate, however, when reasonable minds can reach only one conclusion on the facts presented. *Vallandigham v. Clover Park School District No. 400,* 154 Wn.2d 16, 26, 109 P.3d 805 (2005); *Washington Imaging Services, LLC, v. Washington State Department of Revenue,* 153 Wn.App. 281, 287-88, 222 P.3d 801 (2009).

One of the issues presented involves the interpretation of the terms of a contract. Such questions can be decided on summary judgment when the interpretation does not depend on extrinsic evidence or when the extrinsic can lead to only one conclusion. *Tanner Electric Cooperative v. Puget Sound Power & Light Co.,* 128 Wn.2d 676, 674, 911 P.2d 1301

(1998); *Save Columbia CU Committee v. Columbia Credit Union,* 134 Wn.App. 175, 181, 139 P.3d 386 (2006).

The trial court's initial summary judgment ruling was initiated by the Thorbeckes' motion. The trial court denied their motion but ruled that there was no genuine issue of material fact on the question of whether Hit had sold a franchise to the Thorbeckes. Such a ruling is proper when warranted by the facts. When a case is not fully decided on the motion, the Court must determine what material facts are actually and in good faith controverted. It is then required to make an order specifying the facts that appear without substantial controversy. CR 56(d).

II. The Trial Court Correctly Determined that Hit Did Not Sell a Kahala Franchise to the Thorbeckes.

a. Introduction.

The trial court determined that Hit did not sell a franchise to the Thorbeckes and that there was no genuine issue of material fact on this issue. Its decision was correct.

b. Rules for Interpretation of Contracts.

The Thorbeckes' summary judgment motion presented a question of interpretation of the contract between the parties. Interpretation is the process where the Court determines the meaning of the words that the parties have used in their contract. *Berg v. Hudesman,* 115 Wn.2d 657, 663, 801 P.2d 222 (1990).

The Court must ascertain the parties' intentions when it interprets the meaning of a contract. This is generally done by reviewing the words that the parties have used in their contract and giving those words their ordinary meaning. *Hearst Communications, Inc., v. Seattle Times Company,* 154 Wn.2d 493, 504, 115 P.3d 262 (2005).

The Court is also obliged to employ the context rule to discover the parties' intentions. This rule allows the Court to examine extrinsic evidence where that evidence gives meaning to the words used in the contract. The extrinsic evidence can only be used to elucidate what was written not what was intended to be written. *Berg v. Hudesman, supra*; *Hollis v. Garwall,* 137 Wn.2d 683, 695-96, 974 P.2d 836 (1999). This exercise requires viewing the contract as a whole. The Court must look at the subject matter and intent of the contract. It must also examine the circumstances surrounding the contract's formation; the subsequent acts and conduct of the parties; the reasonableness of the respective interpretations advanced by the parties; and statements made by the parties during negotiations. *Berg v. Hudesman, supra*; *Adler v. Fred Lind Manor,* 153 Wn.2d 331, 351-2, 103 P.3d 773 (2004).

Washington follows the objective theory of contracts. That rule requires a Court to focus on a party's objective manifestations of intent as opposed to his or her unexpressed subjective intention. In this context, a party's unexpressed intentions are not relevant because they are meaningless. *Dwelley v. Chesterfield,* 88 Wn.2d 331, 560 P.2d 353 (1977); *Olympia Police Guild v. City of Olympia,* 60 Wn.App. 556, 805 P.2d 245 (1991); *Watkins v. Restorative Care Center, Inc.*, 66 Wn.App. 178, 831 P.2d 1085 (1992).

Extrinsic evidence cannot be used, however, to show an intention independent of the contract. It can also not be used to vary, contradict, or modify the written word. *Hollis v. Garwall, supra,* 137 Wn.2d at 695.

The Thorbeckes have brought to the Court's attention that rule of contract construction that requires ambiguous language to be construed against the drafter. However, resort to that rule is not necessary if the Court can otherwise determine the parties' intentions. *Roberts, Jackson & Associates, v. Pier 66 Corporation,* 41 Wn.App. 64, 702 P.2d 137 (1985); *Forest Marketing Enterprises v. State, Dept. of Natural Resources,* 125 Wn.App. 126, 104 P.3d 40 (2005).

///

c. The Language of the Contract Cannot Be Interpreted to Conclude That Hit Sold a Franchise.

The Thorbeckes agreed to a purchase price of $170,000.00 for what they bought. The parties executed several documents. The first of these is the Agreement to Sell Business. Paragraph 1 of that document states:

> The total purchase price for all fixtures, furnishings and equipment is $170,000.00 Dollars. . .(reciting method of payment)

(CP 408) There is nothing in Paragraph 1 mentioning any sale of the franchise. The language could not be clearer. The entirety of the purchase price went for fixtures, furnishings and equipment.

Schedule A to the Agreement to Sell Business listed the assets that were being sold. There is nothing on that schedule concerning any franchise. (CP 411)

The Bill of Sale is Schedule D. In that document Hit conveyed as follows:

> 1. All and singular, the goods and chattels, property and effects, listed in Schedule "A" annexed hereto, which is incorporated herein and made a part hereof; and
>
> 2. The whole of the good will of the Samurai Sam's Teriyaki Grill formerly operated by the undersigned which is the subject of this sale.

The document went on to say:

> The undersigned hereby warrants and covenants that I shall not within five years of the date of this instrument engage in the business of Samurai Sam's Teriyaki Grill within ten miles.

(Underlining in the original; CP 416)

The language of Paragraph 1 together with Schedule A and the first paragraph of the Bill of Sale should end the discussion. The Agreement for Sale of Business stated that the Thorbeckes were buying "fixtures, furnishings, and equipment" for the entirety of the purchase price, $170,000.00. The paragraph does not mention any franchise or franchise rights. Schedule A discusses exactly what is being sold. The franchise or any franchise rights are not mentioned there either. Finally, the Bill of Sale conveys title to property listed on Schedule A. It does not state that the franchise or any rights under the franchise agreement are being conveyed. Reasonable people would interpret these documents in one way — that there was no sale or conveyance of any franchise or rights under a franchise agreement.

Nonetheless, the Thorbeckes have made several contentions that will be addressed in turn.

First of all, the Thorbeckes focus on language in the recitals of the Agreement to Sell Business to the effect as follows:

> Seller desires to sell and buyer desires to buy the business now being operated at 1401 SE 164th

> Avenue #150, Vancouver, Washington and known as Samurai Sam's Teriyaki Grill and all assets contained thereof as contained as in Schedule "A" attached hereto.

(CP 408) If this recital is read to mean that the Thorbeckes were buying the Kahala franchise, Hit is not bound by it. A party is not bound by a false recital and may introduce parol evidence to refute it. *Cook v. Vennigerholz,* 44 Wn.2d 612, 616-17, 269 P.2d 824 (1954); *Federal Finance Co. v. Humiston,* 66 Wn.2d 648, 651, 404 P.2d 465 91965); *Northern State Construction Co. v Robbins,* 76 Wn.2d 357, 365 457 P.2d 187(1969) Here, parol evidence is not necessary. The refutation of the claim that the franchise was sold is contained in the plain language of Paragraph 1 of the Agreement to Sell Business, Schedule A, and the Bill of Sale. As Paragraph 1 states, the entirety of the purchase price was for "fixtures, furnishings, and equipment," and neither Schedule A nor the Bill of Sale contain any reference to the franchise.

The Thorbeckes then refer to the language of the Bill of Sale that conveys good will as set out on the preceding page. They argue that the inclusion of the term "goodwill" in the Bill of Sale of Business means that Hit intended to convey the Kahala Franchise to the Thorbeckes. That argument must be rejected for one simple and obvious reason — there is no mention of any franchise on the Bill of Sale or anywhere else in the documents for that matter. Furthermore, the goodwill of a business is something apart from its other assets. It is:

> This good-will may be properly enough described to be the advantage or benefit which is acquired by an establishment beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.

(Emphasis added) *Pollock v. Ralston,* 5 Wn.2d 36, 44, 104 P.2d 934 (1940). The Kahala franchise was one of the intangible assets that Hit had. Since goodwill is something apart from other assets, it cannot include the franchise.

Furthermore, goodwill may be absent when a contract is terminable. *Berg v. Settle,* 70 Wn.2d 864, 425 P.2d 635 (1967). The Kahala franchise lasted for a period of ten years. (CP 64). While it was capable of being renewed, renewal was not a foregone conclusion. For example, the franchisee could not be in default under the terms of the agreement and have an existing right to maintain possession of the premises where the restaurant was located. (CP 84-85) Since the Kahala franchise was terminable and was given only for a finite term, it could not be a component of goodwill.

Finally, the conveyance of good will is consistent with the non-competition provision contained within the Bill of Sale. Hit had agreed not to operate a Samurai Sam's restaurant within ten miles of the 164^{th} Ave. location. In light of that promise, Hit would have no further interest in the restaurant's good will.

d. Extrinsic Evidence Cannot Be Considered.

Only admissible evidence can be considered in a summary judgment motion. CR 56(e) The Thorbeckes desire to rely on extrinsic evidence to show that Hit sold them the Kahala franchise. That evidence is not admissible, however. As discussed above, the terms of both Paragraph 1 of the Agreement to Sell Business, Schedule A to that agreement, and the Bill of Sale must all be interpreted to mean that the Kahala franchise was not an asset that Hit sold. Extrinsic evidence cannot be used to show an intention independent of the writing or to vary, modify, or contradict the writing's terms. *Hollis v. Garwall, supra.* Since the Thorbeckes wish to use the extrinsic evidence both to vary the words of the written memorial of the parties' agreement and to show some independent intention, the extrinsic evidence is not admissible and should not be considered.

///

e. Even if Considered, the Extrinsic Evidence Supports the Conclusion that Hit Did Not Sell the Kahala Franchise.

Several aspects of extrinsic evidence confirm that Hit did not sell a franchise to the Thorbeckes. These will be discussed in turn.

First of all, the parties' discussions show that the Thorbeckes did not buy the Kahala franchise. They understood that they might have to pay a transfer fee in order to have the franchise transferred to them. They did not want to pay this fee. Therefore, the parties agreed that the Thorbeckes would subcontract from Hit — that they would work under its franchise agreement.

The parties' subsequent conduct also shows that there was no sale of the franchise. The parties acted as if the Thorbeckes were subcontracting from Hit just as they had agreed to do. Mr. Klutz, on behalf of Hit, helped with the computation of royalty payments. The Thorbeckes would then pay these sums to Mr. Klutz. He would then forward them on to Kahala.

Finally, the Kahala franchise agreement makes it clear that Kahala must approve any transfer of the franchise. No one ever initiated this process. Furthermore, the Thorbeckes confirmed their unwillingness to pay a transfer fee when Kahala, through Mr. Anderson, suggested that they should make appropriate application for a transfer of the franchise in the summer of 2007. If the Thorbeckes believed they had purchased a franchise, and especially given Mr. Leonard's familiarity with Kahala, they would have sought Kahala's approval. Their failure to even attempt to obtain that approval shows that there was no sale of any franchise.

f. The Extrinsic Evidence on Which the Thorbeckes Rely Is Otherwise Inadmissible.

i. Evidence of Value of the Equipment Is Not Admissible.

The Thorbeckes' contend that they must have purchased a franchise because the value of the assets of the equipment that they purchased was approximately $10,000.00. (Brief of Appellant, pps. 16-19) This evidence is inadmissible for two reasons.

First of all, there is no evidence that the parties ever discussed this issue in formulating the purchase price. Extrinsic evidence is inadmissible if it amounts to a party's unexpressed intention. *Dwelley v. Chesterfield, supra; Hollis v. Garwall, supra; Olympia Police Guild v. City of Olympia, supra.*

Secondly, under the clear terms of Paragraph 1 and Schedule A of the Agreement for Sale of Business, however, the Thorbeckes did indeed purchase "fixtures, furnishings, and equipment" for $170,000.00. They cannot vary or contradict the terms of the writing by extrinsic evidence as noted above. *Hollis v Garwall, supra.*

If the Thorbeckes' estimate of value is to be believed, they made a very bad business decision when they entered into these agreements. However, courts will not relieve a party of a bad bargain even when franchise arrangement is concerned. *Snap-On Tools Corp. v. Roberts* 35 Wn.App. 32, 665 P.2d 417 (1983).

ii. Evidence of the Thorbeckes' Intentions Is Inadmissible.

The Thorbeckes claim they "believed they were purchasing the restaurant and they would be able to continue operating the restaurant as a franchise of Samurai Sam's and would not have purchased the restaurant had the sale not included the franchise rights." (Amended Opening Brief, p. 25) There is no evidence that they made this statement to any Hit representative. The Thorbeckes' belief is therefore nothing more than an unexpressed intention that is inadmissible as extrinsic evidence. *Dwelley v. Chesterfield, supra; Hollis v. Garwall, supra; Olympia Poice Guild v. City of Olympia, supra.* It cannot be used to raise a genuine issue of material fact.

The Thorbeckes also claim that they believed that Hit could transfer franchise rights to them. (Amended Opening Brief, p. 25) Hit no doubt could do so — subject to Kahala's approval. (CP 80-81) The Thorbeckes' belief is not particularly helpful. The issue is whether

Hit sold the franchise to the Thorbeckes not whether it had authority to do so. As noted above, the Thorbeckes declined to purchase the franchise because they didn't want to pay the transfer fee.

iii. Conclusion.

Even if extrinsic evidence could be considered, the extrinsic evidence the Thorbeckes have offered is inadmissible. It therefore cannot be considered. CR56(e)

g. Conclusion.

The trial court's conclusion that Hit had not sold a franchise to the Thorbeckes was not error. The trial court correctly interpreted the parties' contract by ruling that Hit did not sell or convey a Kahala franchise to the Thorbeckes. This interpretation is properly made based upon the documents the parties executed as part of their contract and without the need to resort to extrinsic evidence. Therefore, summary judgment on that issue is and was appropriate. Even if extrinsic evidence is considered, it can lead to only one conclusion — that the franchise was not among the assets that Hit sold. The trial court's ruling to that effect was therefore not error and must be affirmed.

IV. <u>The Thorbeckes Are Not Entitled to Relief under the Franchise Investment Protection Act</u>.

The Thorbeckes have strenuously argued that Hit sold them a franchise. They have not advised the Court as to why this issue is important or to what relief they would be entitled if a trier of fact might find that they indeed had purchased a franchise. The answer they filed gives us some idea. They alleged affirmative defenses and counterclaims for fraud and for relief under RCW 19.100, Washington's Franchise Investment Protection Act. (CP 126-28) In their prayer, they asked for damages based on their counterclaims and for relief under RCW 19.86 and RCW 19.100.190(5) for "failing to register and comply with the Franchise Investment Act." (CP 128-29) They apparently abandoned their fraud claim because they never raised it when Hit moved for summary judgment. (CP 535-40) Even if Hit did sell them a franchise, they are not entitled to relief under RCW 19.100 as will be discussed below.

As indicated, the Thorbeckes invoked RCW 19.100.190 in their answer. That statute provides as follows in pertinent part:

> Any person who sells or offers to sell a franchise in violation of this chapter shall be liable to the franchisee or subfranchisor who may sue at law or in equity for damages caused thereby for rescission or other relief as the court may deem appropriate...

Also in their Answer, the Thorbeckes allege that Mr. Klutz sold them an unregistered franchise and also did not provide them with a registered and approved offering circular. (CP 127-28) To be sure, a franchisor must register the franchise before it can sell one. As RCW 19.100.020(1) provides:

> It is unlawful for any franchisor or subfranchisor to sell or offer to sell any franchise in the state unless the offer of the franchise has been registered under this chapter or exempted under RCW 19.100.030.

Any application for registration must be accompanied by an offering circular. This requirement is set out in RCW 19.100.040 as follows:

> (1) The application for registration of the offer, signed by the franchisor, subfranchisor, or by any person on whose behalf the offering is to be made, must be filed with the director and shall contain:
>
> (a) A copy of the franchisor's or subfranchisor's offering circular which shall be prepared in compliance with guidelines adopted by rule of the director. . .

That offering circular must be delivered to the offeree as required by RCW 19.100.080, which provides:

> It is unlawful for any person to sell a franchise that is registered or required to be registered under this chapter without first delivering to the offeree, at least ten business days prior to the execution by the offeree of any binding franchise or other agreement, or at least ten business days prior to the receipt of any consideration, whichever occurs first, a copy of the offering circular required under RCW 19.100.040. . .

Under this combination of statutes, the Thorbeckes would be entitled to rescind the entire transaction if Hit was required to deliver an offering circular to them but did not do so. RCW 19.100.190(2). This rescission would, presumably, be a defense to Hit's suit on the promissory note.

First of all, Hit did not sell a Kahala franchise to the Thorbeckes. The terms of the Agreement for Sale of Business, Schedule A, and the Bill of Sale make that clear. Even if it could be said that the franchise was somehow conveyed to the Thorbeckes, it was certainly done without the payment of any consideration. As Paragraph 1 of the Agreement for Sale of Business states, the entire purchase price went for "fixtures, furnishings, and equipment." Therefore, if the franchise was conveyed, it was not through a "sale." That term is defined to mean a transfer for a price. The verb "sell" means to transfer by a sale. *Balck's Law Dictionary* (8th Ed. 2004). In the absence of a sale, the registration requirements and the need to provide an offering circular are not applicable.

Even if Hit had sold a franchise to the Thorbeckes, it was not required to register with the Department of Financial Institutions. Only franchisors and subfranchisors are required to register as RCW 19.100.020(1) states. Hit was neither. The term "franchisor" refers to "a person who grants a franchise to another person." RCW 19.100.010(8). A "subfranchisor" is a "person to whom a subfranchise is granted." RCW

19.100.010(10). And a "subfranchise" is an "agreement, express or implied, oral or written, by which a person pays or agrees to pay, directly or indirectly, a franchisor or affiliate for the right to sell or negotiate the sale of the franchise." RCW 19.100.010(9). Clearly, Hit was not a franchisor. In this context, Kahala is the franchisor. Hit was also not a subfranchisor. It had not agreed to pay a franchisor for the right to grant, sell, or negotiate the sale of a franchise.

Even if Hit can be termed a franchisor or subfranchisor, the transaction is exempt from the registration requirements of RCW 19.100. Those requirements do not apply to:

> The offer or sale or transfer of a franchise by a franchisee who is not an affiliate of the franchisor for the franchisee's own account if the franchisee's entire franchise is sold and the sale is not effected by or through the franchisor. A sale is not effected by or through a franchisor merely because a franchisor has a right to approve or disapprove the sale or requires payment of a reasonable transfer fee. Such right to approve or disapprove the sale shall be exercised in a reasonable manner.

RCW 19.100.030(1). Hit clearly qualifies as a franchisee. It is undisputed that it made to the Thorbeckes for its own account. (CP 343) The sale was obviously not effected through Kahala. It learned of the sale over a year after it had occurred.

Hit was also not an "affiliate" of Kahala. That term is defined as follows:

> "Affiliate" means a person controlling, controlled by, or under common control with another person, every officer or director of such person and every person occupying a similar status or performing similar functions.

RCW 19.100.010(2). Hit cannot be an affiliate of Kahala under that definition. There is no common control between the two entities.

No prior Washington opinion has been located addressing the application of RCW 19.100.030(1). In *Dale v. Black,* 81 Wn.App. 599, 915 P.2d 1116 (1996), the Court considered a version of RCW 19.100.030(1) as it read prior to its amendment in 1991. *Dale v. Black, supra*, 81 Wn.App. at 602; Chisum *State Regulation of Franchising: The Washington Experience,* 48 Wash.L.Rev. 291, 347-48 *fn.* 285 (1973). Therefore, the decision in *Dale v. Black, supra,* is not helpful.

Indiana's Franchise Disclosure Act contains an exemption substantially the same as RCW 19.100.030(1) in Ind.Code § 23-2-2.5-4 as follows:

> The offer of sale of a franchise by a franchisee who is not an affiliate of the franchisor for his own account is exempt from (the Indiana equivalent of RCW 19.100.080) if the offer or sale is not effected by or through a franchisor. A sale is not effected by or though a franchisor if a franchisor is entitled to approve or disapprove a different franchisee.

In *Drake v. Maid-Rite Co.,* 681 N.E.2d 734 (Ind.App. 1997), the Court relied on this statute to hold that a franchisor was not obliged to provide an offering statement to a person buying a restaurant—along with a franchise—from a franchisee who made the sale on his own account.

The decision of the Indiana Court of Appeals was based on the clear statutory language. There is no reason to construe RCW 19.100.030(1) any differently. Hit made the sale to the Thorbeckes on its own account. It was therefore not obliged to comply with the registration and circular offering requirements of RCW 19.100. Therefore, even if Mr. Klutz sold the Thorbeckes a franchise, they would not be entitled to any relief under RCW 19.100.

The Thorbeckes are apparently attempting to defend Hit's action on the promissory note by alleging that Hit failed to comply with certain requirements set out in RCW 19.100. They have contended that Hit sold them a franchise so that they can take advantage of the relief RCW 19.100 allows. As this discussion shows, even if Hit had sold a franchise to the Thorbeckes, they would be entitled to no relief based upon a failure to comply with the requirements of RCW 19.100. A trial court judgment may be affirmed on any grounds supported by the record. *Mountain Park Homeowners Association, Inc. v. Tydings,* 125 Wn.2d 337, 344, 883, P.2d

1383 (1994); *Hendrickson v. King County,* 101 Wn.App. 258, 266, 2 P.3d 1006 (2000). Because of that rule and the *de novo* standard of review in which the Court engages, the trial court must be affirmed even if the Court determines that it should not have ruled on summary judgment that Hit had not sold a franchise to the Thorbeckes.

V. The Thorbeckes Sought No Other Relief.

After the trial court entered the Order on Motion for Summary Judgment indicating that Hit had not sold a franchise to the Thorbeckes, Hit moved for summary judgment on the promissory note the Thorbeckes had given for the balance of the purchase price. In response, the Thorbeckes did not claim any rights to relief under RCW 19.100. They may have perceived that the trial court's ruling eliminated any claims they had under that statute. Nonetheless, the Thorbeckes retained claims and defenses to payment on the note that exist outside of RCW 19.100. In particular, they had alleged fraud as an affirmative defense and a counterclaim. (CP 125-27) They had also alleged breach of contract and rescission as affirmative defenses. (CP 125) The Thorbeckes raised none of these issues in their response to Hit's summary judgment motion. (CP 535-39) They also made no such contention in the Brief of Appellant.

A party who fails to raise a contention at the motion for summary judgment is precluded from making that argument to the Appellate Court.

RAP 2.5(a) Therefore, the Thorbeckes should not claim now that they are entitled to relief based on fraud, breach of contract, or common law rescission.

An appellate court also will not consider an issue raised for the first time in a reply brief. *Cowiche Canyon Conservancy v. Bosley,* 118 Wn.2d 801, 809, 828 P.2d 549 (1992); *West v. Thurston County,* 144 Wn.App. 573, 580, 183 P.3d 346 (2008) Therefore, the Thorbeckes are precluded from presenting new claims as to why they are not liable under the terms of the promissory note that are not in their (Amended Opening Brief)

VI. <u>Attorney's Fees.</u>

Hit sought attorney's fees under the terms of the following provision in the promissory note:

> Attorney's fees and costs: Maker shall pay all costs incurred by Holder in collecting sums due under this Note after default, including reasonable attorneys' fees whether or not suit is brought. If Maker or Holder sues to enforce this Note or obtain a declaration of its rights hereunder, the prevailing party in any such proceeding shall be entitled to recover its reasonable attorneys' fees and costs in the proceeding (including those incurred in any bankruptcy proceeding or appeal) from the non-prevailing party.

///

Motion for Summary Judgment because of the existence of genuine issues of material fact. If the Court of Appeals reverses, the Thorbeckes will be entitled to a trial and nothing more. At that trial, they may prevail or not. When reversal requires additional proceedings to determine who will ultimately prevail, all issues concerning attorney's fees abide the outcome. *Perry v. Moran,* 109 Wn.2d 691, 705, 748 P.2d 224 (1987); *Busch v. Nervik,* 38 Wn.App. 541,549, 687 P.2d 872 (1984); *Hessler Construction Co. Inc., v. Looney,* 52 Wn.App. 110, 113, 757 P.2d 988 (1988)

The case of *Perry v. Moran, supra,* provides an example of this rule in a situation conceptually identical to ours. Plaintiff sued an employee to enforce a restrictive covenant. The trial court ruled that the covenant was unreasonable, found in defendant's favor, and awarded her attorney's fees. The Supreme Court held that the covenant was reasonable and remanded the matter for further proceedings. It held that all questions concerning attorney's fees should abide the final disposition of the case.

In short, if the matter is reversed, all questions concerning attorney's fees should abide the ultimate resolution of the case.

STATEMENT REQUIRED BY RAP 18.1

This section of the brief is submitted to comply with the requirements of RAP 18.1(a). Mr. Klutz requests attorney's fees on appeal. His request is based on the provision in the promissory note set out above. By its terms, it requires an award of attorney's fees on appeal. Even without the explicit reference to attorney's fees on appeal, contractual language allowing attorney's fees to the prevailing party support an award of attorney's fees on appeal. *Thompson v. Lennox,* 151 Wn.App. 479,491, 212 P.3d 597 (2009).

CONCLUSION

Mr. Klutz did not sell a franchise to the Thorbeckes. The trial court correctly determined that the question did not raise any genuine issue of material fact. Even if Mr. Klutz had sold a franchise to the Thorbeckes, they would not have been entitled to any relief under RCW 19.100. For all these reasons, the trial court's judgment should be affirmed and Mr. Klutz should be awarded his reasonably attorney's fees on appeal.

DATED this 12 day of APRIL, 2010.

BEN SHAFTON, WSB #6280
Of Attorneys for Respondents

FILED
COURT OF APPEALS
DIVISION II

10 APR 14 PM 1:26

STATE OF WASHINGTON

BY [signature]
DEPUTY

NO. 39853-2-II
COURT OF APPEALS
DIVISION II
STATE OF WASHINGTON

KAHALA FRANCHISE CORP., a Delaware corporation,

Plaintiff,

v.

HIT ENTERPRISES, LLC a Washington limited liability company; and THOMAS S. KLUTZ, JR., and HEIDI KLUTZ, husband and wife,

Defendants & Third Party Plaintiffs/Respondents,

v.

DRAGON FIRE INVESTMENTS, LLC, a Washington limited liability company; REGINA NORBY-THORBECKE and WILLIAM THORBECKE, husband and wife; KYLE LEONARD, a single man; RODNEY MANZO, a single man; and CHRISTOPHER BOYD and JANE DOE BOYD, husband and wife,

Third-Party Defendants/Appellants (Dragon Fire & Thorbeckes)

APPEAL FROM THE SUPERIOR COURT

HONORABLE ROBERT L. HARRIS

AFFIDAVIT OF MAILING

BEN SHAFTON
Attorney for Defendants & Third Party Plaintiffs/Respondents
Caron, Colven, Robison & Shafton
900 Washington Street, Suite 1000
Vancouver, WA 98660
(360) 699-3001 * E-mail: bshafton@ccrslaw.com

STATE OF WASHINGTON)
) ss.
County of Clark)

THE UNDERSIGNED, being first duly sworn, does hereby depose and state:

1. My name is LORRIE VAUGHN. I am a citizen of the United States, over the age of eighteen (18) years, a resident of the State of Washington, and am not a party to this action.

2. On April 12, 2010, I deposited in the mails of the United States of America, first class mail with postage prepaid, a copy of the BRIEF OF RESPONDENTS to the following person(s):

Mr. Robert Mitchelson
Mitchelson Law Office
P.O. Box 87096
Vancouver, WA 98687-7096

I SWEAR UNDER PENALTY OF PERJURY THAT THE FOREGOING IS TRUE AND CORRECT TO THE BEST OF MY KNOWLEDGE, INFORMATION, AND BELIEF.

DATED this 12th day of april, 2010.

Lorrie Vaughn
LORRIE VAUGHN

SIGNED AND SWORN to before me this 12th day of April, 2010.

BEN SHAFTON
COMMISSION EXPIRES
NOTARY
PUBLIC
SEPTEMBER 1, 2011
STATE OF WASHINGTON

NOTARY PUBLIC FOR WASHINGTON
My appointment expires: 9.1.2011