

COURT OF APPEALS
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STATE OF WASHINGTON
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Case No. 44915-3-II

COURT OF APPEALS, DIVISION II,
OF THE STATE OF WASHINGTON

GOLDBERG FAMILY INVESTMENT CORPORATION,
a Washington corporation,

Appellant,

v.

WILLIAM D. QUIGG and CAROL QUIGG,
and the marital community comprised thereof; and
PATRICK D. QUIGG and KATHLEEN A. QUIGG,
and the marital community comprised thereof,

Respondents.

APPELLANT'S OPENING BRIEF

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ORIGINAL

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I. INTRODUCTION

The Appellant, the Goldberg Family Investment Corporation, was a Member of a Washington limited liability company, Grays Harbor Paper LLC (hereafter “LLC”). LLC was a successor entity to a limited partnership, Grays Harbor Limited Partnership (hereafter “LP”) in which Appellant was a Limited Partner.

The Respondents are William Quigg and Patrick Quigg and their respective marital communities. William Quigg, acting through a wholly-owned corporation, Grays Harbor International Inc. (“GHI”), was the Managing Partner of LP. Patrick Quigg, acting through a corporation controlled by Patrick Quigg, Quigg Investments Inc. (“QII”), was both a Manager of and a Limited Partner in LP.

LP was reconstituted as LLC in 2009. It is not in dispute that any rights or claims held by LP passed to LLC in this process, and that no claims held by anyone were released in the process. Appellant, GHI and QII were Members of LLC. The overall management of LLC was vested in a Board of Directors which included William Quigg. However, the day-to-day management of GHPLLC was controlled by William Quigg and Patrick Quigg.¹

Both the LP Amended and Restated Limited Partnership Agreement (the “LP Agreement”) and the LLC Limited Liability Company Agreement (the “LLC Operating Agreement”) contain arbitration provisions (respectively *CP 56-57 at § 27; and CP 129-130 at §16.1 and §16.3*).

¹ William Quigg and Patrick Quigg are collectively referred to as “the Quiggs.”

Respondents have conceded that the arbitration under either agreement is governed by the Federal Arbitration Act (9 U.S.C. §§ 1-14) (hereafter “FAA”) as specified in the LLC Operating Agreement at §16.3. (*CP 440 at ll. 16-17*).

On or about October 31, 2011, Appellant gave a “Notice of Dispute” as required under the various agreements to initiate arbitration. (*CP 6-16 excluding exhibits*). The Notice of Dispute alleges, in sum, that the Quiggs used their positions of authority within LP and LLC to cause LP and LLC to enter into “sweetheart” contracts with other entities owned and controlled by the Quiggs which improperly drained LP and LLC of operating capital causing the failure of LLC and the loss of Appellant’s investment. The Notice of Dispute further alleged that the Quiggs’ conduct satisfied the standard for ignoring the business entities used by the Quiggs, and that the Quiggs’ conduct was basis for liability under Washington’s Limited Partnership Statute (Chap. 25.10 RCW) and the Limited Liability Company Statute (Chap. 25.15 RCW).

Respondents refused to arbitrate (*CP 212-213*), after which Appellant filed a Complaint to Compel Arbitration (*CP 1-4 excluding exhibits*). This appeal is taken from an Order dismissing that Complaint and from a contemporaneous denial of Appellant’s Motion to Compel Arbitration. (*CP 170-176*). The basis for dismissal was that Appellant “lacks standing to bring its claims and is not the real party in interest.” (*CP 485 at l. 12*). As discussed below, that Order was based on the erroneous legal conclusion that a limited liability company Member could *not* have independent claims for damages against a Manager arising from a

course of conduct which was also a basis for claims by the limited liability company against the Manager. Moreover, the Order was equally erroneous in that the issue of whether Appellant had standing was, in fact, an issue for the arbitrator and not for the Trial Court.

The Trial Court also struck certain portions of Appellant's pleadings summarizing the allegations of the Notice of Dispute on the basis that the statements struck were hearsay. As the summaries were not offered to prove the allegations of the Notice of Dispute so as to inform the Trial Court as to the nature of the dispute, the statements were not hearsay, and Appellant's appeal from this Order as well.

II. ASSIGNMENTS OF ERROR

Appellant assigns the following errors to the Trial Court.

A. Assignment of Error No. 1.

The Trial Court committed error by failing to order the dispute to arbitration instead dismissing on the issue of Appellant's standing because the standing issue was an issue for the arbitrator.

1. Issues Presented. In a case governed by the FAA, was the issue of Appellant's standing an issue for the arbitrator and not the Trial Court? In other words, should the Trial Court have ordered the defense of lack of standing to the claims asserted in the Notice of Dispute to arbitration instead of ruling on the standing issue itself?

2. Summary. Washington Courts have repeatedly adopted the interpretation of the FAA by Federal Courts that only defenses to enforceability of the arbitration provision itself should be resolved by the

Trial Court. Accordingly, the Trial Court lacked authority to resolve a substantive defense to the claims asserted in the Notice of Dispute.

B. Assignment of Error No. 2.

The Trial Court committed error by ruling that, as a matter of law, a Member of a limited liability company could not have independent claims for damages against a Manager arising from a course of conduct which was also a basis for claims by the limited liability company against the Manager.

1. Issues Presented. Can the same course of conduct by the Manager of a limited partnership or limited liability company give rise to claims which can be asserted by the limited partnership/limited liability company as well as the Limited Partners/Members against the Manager?

2. Summary. The Uniform Limited Partnership Act and the Uniform Limited Liability Act have in common that each separately enumerates essentially identical standards pursuant to which a Manager can be held liable to the Limited Partners/Members for misconduct, as well as standards by which Limited Partners/Members may derivatively assert claims held by the entity. Thus, the statutes themselves recognize that Limited Partners/Members can have claims independent of the partnership/limited liability company against a Manager. Moreover, the authority explicitly recognizes that the entity and the Limited Partners/Members may have separate causes of action arising from the same course of conduct.

C. Assignment of Error No. 3.

The Trial Court committed error by striking references in Appellant's pleadings to allegations made in the Notice of Dispute as hearsay because neither the Notice of Dispute nor the references in Appellant's pleadings were offered to prove the truth of the matter asserted.

1. Issues Presented. Can a reference to a factual allegation in the Notice of Dispute be hearsay where the allegation and reference are offered only to show what the allegations on which the claims in the Notice of Dispute are, and not to prove the truth of the allegation?

2. Summary. Evidence not offered to prove the truth of the matter asserted in the evidence cannot be hearsay as a matter of law.

III. STATEMENT OF THE CASE

As stated at § 3(a) of the LP Agreement (*CP 22*), LP was formed in 1994 to own and operate a paper mill located in Grays Harbor County, Washington. Appellant was a Limited Partner in LP. The General Partner of LP was GHI, a corporation solely owned and controlled by William Quigg. (*CP 22*). Acting through another wholly-owned corporation, WDQ Investments Inc., William Quigg was also as Limited Partner of LP. (*CP 22*). As alleged in the Notice of Dispute, Patrick Quigg was the comptroller of LP and, as with William Quigg, a Limited Partner of LP through a wholly-owned corporation, QII. (*CP 6-7*).

Both William Quigg and Patrick Quigg are signatories of the LP Agreement (*respectively CP 57 and CP 62*), albeit in their capacity as authorized agents of their respective wholly-owned companies. The LP Agreement provides:

Any dispute, controversy or claim arising out of or in connection with, or relating to this Agreement or any breach or alleged breach hereof, upon the request of any party involved, shall be submitted to, and settled by, arbitration in Grays Harbor County, Washington...

(CP 56 at § 27).

In 2009, the limited partnership (LP) was merged into the limited liability company (LLC). The limited partnership interests of each Limited Partner in LP were converted to limited liability company shares in LLC. The management of LLC was vested in a Board of Directors. *(CP 110-113, Article VI)*. The LLC Operating Agreement is *CP 99-153*. Both William Quigg and Patrick Quigg are signatories of the LLC Operating Agreement *(respectively CP 134, 147 and CP 146)*, albeit in their capacity as authorized agents of their respective wholly-owned corporations, The LLC Operating Agreement provides for mandatory arbitration of any dispute relating to GHPLLC in the broadest possible language:

Any controversy, claim or dispute of whatever nature arising between any of the parties under this Agreement, the other Transaction Documents or in connection with the transactions contemplated hereunder, including those arising out of or relating to the breach, termination, enforceability, scope or validity hereof, whether such claim existed prior to or arises on or after the date hereof ..., shall be resolved by mediation or, failing mediation, binding arbitration.

(CP 129 at § 16.1). Respondents have conceded that arbitration under this provision is governed by the FAA. *(CP 440 at ll. 16-17)*.

On its face, the arbitration provision in the LLC Operating Agreement extends to disputes arising during the existence of LP as the provision extends to claims which existed “prior to” the effective date of

the LLC Operating Agreement. Moreover, a “claim or dispute of whatever nature arising...in connection with the transactions contemplated hereunder” would encompass transactions between LLC and the various Quigg-controlled entities which are the subject of the claims in Appellant’s Notice of Dispute. The Notice of Dispute is CP 9-16 (excluding exhibits).

LLC ceased business operations in 2011. A receiver was appointed by the Grays Harbor County Superior Court on June 6, 2011. (*CP 215-224*). The receivership has now been terminated. (*CP 226-228*).

As required under § 16.2 of the LLC Operating Agreement, Appellant served a Notice of Dispute on Respondents on or about October 31, 2011. (*CP 9-16 excluding exhibits*). The basic allegation is that, during the existence of LP/LLC, the Quiggs utilized GHI to engage in self-dealing contracts between LP/LLC and various entities owned and controlled by the Quiggs. The Notice of Dispute further alleges that this conduct constituted breaches of duties owed to Appellant. This self-dealing resulted in the improper transfer of many millions of dollars from LP/LLC to entities owned and controlled by the Quiggs and, as alleged, led to the failure of LLC as a business and the consequent loss of Appellant’s investment.

Appellant’s Notice of Dispute also alleges that not only did certain of these practices/contracts continue after the formation of LLC, but, also, that the Quiggs used their control over LLC to prevent claims being asserted for the prior and continuing misappropriation of funds. Finally, the Notice of Dispute alleges that the nature of the conduct involved would allow the separate corporate existence of the entities owned and controlled

by the Quiggs, including the entity acting as the Managing Partner (GHI), to be ignored.

In their Answer (*CP 160-168*), Respondents asserted, both as an affirmative defense and as a counterclaim for declaratory relief, that Appellant did not have any claims distinguishable from the claims that LLC could itself assert as a result of the same course of conduct. In other words, Respondents contended that Appellant's claims are entirely derivative from LLC and can only be asserted by LLC.

Appellant made a Motion to Compel Arbitration to the Trial Court. (*CP 170-176 excluding exhibits*). In the event the Trial Court determined the matter was not arbitrable, Appellant also made a Motion to Dismiss the affirmative defense and counterclaim regarding standing. (*CP 189-194*). In their Response to the Motion to Compel Arbitration, Respondents filed an Opposition and Cross Motion for Summary Judgment (*CP 438-449*) asserting, in sum, that the dispute was not arbitrable for two reasons: (1) the claims belonged to LLC and were not assertable by Appellant; and (2) Respondents were not individually bound by the arbitration provisions. Respondents' Cross-Motion for Summary Judgment, as previously noted, was granted on the basis that Appellant "lacks standing to bring its claims and is not the real party in interest." (*CP 485 at l. 12*). Thus, the sole basis for the decision by the Trial Court was the standing issue.

A copy of the Notice of Dispute was attached to Appellant's Complaint (*CP 1-16 excluding exhibits to Notice of Dispute*) and the Declaration of Paul E. Brain submitted in support of Appellant's Motions to Compel Arbitration and to Dismiss (*CP 196-210*), portions of which

were summarized in Appellant’s Motion to Compel Arbitration to inform the Trial Court as to the allegations which were the basis for the dispute (*CP 170-176 excluding exhibits*). Respondents moved to strike those references (*CP 430-436*) on the basis that the references were hearsay, notwithstanding that none of the information was offered to prove the truth of the allegations. The Trial Court granted Respondents’ Motion to Strike in its entirety. (*CP 482-483*).

IV. APPLICABLE AUTHORITY AND ARGUMENT

A. Appellant’s Motion to Compel Arbitration.

1. The Standard of Review.

The standard of review applicable to a Motion to Compel Arbitration is *de novo*. *Gandee v. LDL Freedom Enterprises, Inc.*, 176 Wn.2d 598, 293 P.2d 1197 (2013).

2. Under the Federal Arbitration Act, Respondents’ Affirmative Defense and Counterclaim Based on a Lack of Standing Would be an Issue for Arbitration and Should Not Have Been Resolved by the Trial Court.

Under the FAA, any question regarding arbitrability should be resolved in favor of arbitration:

The federal policy favoring arbitration requires us to construe arbitration clauses as broadly as possible. Doubts as to arbitrability should be resolved in favor of coverage, ...

Genesco, Inc., 815 F.2d at 847. Respondents conceded (at *CP 445*) that the Trial Court’s “discretion for compelling arbitration is...limited to a two-step process of ‘determining (1) whether a valid agreement to arbitrate exists, and if it does; (2) whether the agreement encompasses the

dispute at issue,' ” citing to Chiron Corp. v. Ortho Diagnostics Systems, Inc., 207 F.3d 1126 at 1130 (9th Cir. 2000). If a trial court concludes these requirements are met, that is the end of the analysis. In this regard, the validity of the agreement to arbitrate was never in dispute.

The transactions which are the basis of Appellant’s Notice of Dispute clearly fall within the scope of the arbitration provisions at issue here and, in fact, Respondents never contended that the claims at issue were not otherwise arbitrable. Rather, Respondents first asserted that the matter was not subject to arbitration because Appellant lacked standing to assert the claims. However, *nowhere in their Response did Respondents actually cite any authority for the proposition that the affirmative defense of standing is a threshold issue to be determined by a trial court as part of the two-step process to be used to determine whether a dispute is arbitrable.*

Rather, Respondents’ argument focused on the fact that Respondents are not personally signatories to either the LP Agreement or the LLC Operating Agreement. While Respondents never so state explicitly, the argument appears to be that the second prong of the two-part test is not met because the arbitration agreement does not encompass disputes involving the Respondents individually.

Federal Courts applying the FAA have consistently recognized that non-signatories to a contract containing an arbitration provision may nevertheless be bound to arbitrate:

This Court has recognized a number of theories under which non-signatories may be bound to the arbitration agreements of others. Those theories arise out of common

law principles of contract and agency law. Accordingly, we have recognized five theories for binding non-signatories to arbitration agreements: 1) incorporation by reference; 2) assumption; 3) agency; 4) veil-piercing/alter ego; and 5) estoppel.

Thomson-CFS, S. A. v. American Arbitration Association, 64 F.3d 773 at 776 (S.D. N.Y. 1995), a point of view also endorsed by Washington Courts. See, e.g., Woodall v. Avalon Care Center-Federal Way, LLC, 155 Wn. App. 919 at 923-924, 231 P.3d 1252 (2010), citing Thomson with approval:

There are limited exceptions to the general rule that one who does not sign an arbitration agreement cannot be compelled to arbitrate. “For instance, a nonsignator is bound by the terms of an arbitration agreement where the nonsignator’s claims are asserted solely on behalf of a signator to the arbitration agreement.” “In addition, federal *924 courts have held, and the Washington Court of Appeals has recognized, that ‘[n]onsignatories of arbitration agreements may be bound by the agreement under ordinary contract and agency principles.’ ” Among these principles are (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing/alter ego; and (5) estoppel.

So, Washington Courts have adopted exactly the same rule adopted by Federal Courts applying the FAA governing the circumstances under which a non-signatory can be compelled to arbitrate.

In this case, there are actually multiple bases on which Respondents, as non-signatories, could be compelled to arbitrate. The first is estoppel. As the Court in Smith/Enron Cogeneration v. Smith Cogeneration, 198 F.3d 88, 97-98 (2d Cir.1999), explained:

In Thomson-CSF we set forth two types of estoppel cases. 64 F.3d at 778-79. The more typical case, as we have

already noted, arises when a signatory to an arbitration agreement seeks to bind a non-signatory to it. We have held that the non-signatory may be compelled to arbitrate when it has derived other benefits under the agreement containing the arbitration clause.

In other words, the non-signatory is estopped from asserting that it is not bound by the arbitration provision where the non-signatory has derived benefit from the contract containing the provision. The conclusion that Respondents derived benefit from their involvement over a period in excess of a decade with LP/LLC is inescapable. Indeed, the basic dispute concerns whether those benefits were improperly gained.

Second, Appellant has asserted a claim of piercing the corporate veil of the entities owned and controlled by the Quiggs, which entities are the signatories to the LP Agreement and the LLC Operating Agreement. A veil piercing/alter ego theory has been recognized both by Federal and State Courts as a basis for compelling a non-signatory to arbitrate.

Third, corporate officers have been regularly held to arbitration provisions to which they are not personally parties. *See, e.g., Wasserstein v. Kovatch*, 261 N.J. Super. 277, 618 A.2d 886 (App. Div. 1993), *certification denied*, 133 N.J. 440, 627 A.2d 1145 (1993).

[T]he claims are all subsumed in the contract dispute and, hence are subject to the arbitration as required by that contract. Thus the individual defendants in the fraud action are entitled to arbitration as agents of [the contractor] even though they had not individually signed an arbitration agreement. All claims against the non-signatory defendants stemmed from their actions relating to or arising out of the performances of the contract by [the contractor]. Non-signatories of an arbitration agreement may be bound by the agreement under contract and agency principles. A contrary view would only subvert the policy of favoring

arbitration and allow an avoidance of an agreement to arbitrate merely by naming the principals of the corporation or non-signatory parties in a complaint.

Here, compelling arbitration is fully consistent with basic principles of contract and agency law.

So, to the extent that the challenge by Respondents to arbitrate goes to the scope of the arbitration provision as it relates to non-signatories, the challenge is without merit. At that point, the Trial Court's analysis should have ended and the matter sent to arbitration.

The exception to the rule, as discussed in more detail below, is where there is a challenge to the enforceability of the arbitration provision as distinguished from the enforceability of the contract. Respondents have never challenged the enforceability of the arbitration provision.

Moreover, in construing the FAA, the U.S. Supreme Court held long ago that, unless the challenge to arbitration goes to the arbitration provision itself, questions of arbitrability must go to the Arbitrator. *See Prima Paint Corp. v. Flood & Conklin Mfg., Inc.*, 388 U.S. 395, 87 S.Ct. 1081 (1967). In *Prima Paint Corp.*, the plaintiff sued in Federal District Court asserting that the defendant had fraudulently induced the plaintiff to enter into the contract containing the arbitration provision. The defendant sought to compel arbitration contending that the issue presented – whether there was fraud in the inducement of the contract – was a question for the arbitrators and not for the Federal District Court. The U.S. Supreme Court concluded that an issue going to the enforceability of the contract as a whole must be heard by the arbitrator under the FAA. Only where the issue concerns the arbitration provision itself would the issue be heard by the

Court. The U.S. Supreme Court reaffirmed this rule in Buckeye Check Cashing Inc. v. Cardegna, 546 U.S. 440 at 445-446 (2006).

This interpretation of the FAA has been repeatedly adopted by Washington Courts. See, Pinkis v. Network Cinema Corp., 9 Wn. App. 337, 512 P.2d 751 (1973); and Allison v. Medicab Inter. Inc. 92 Wn.2d 199, 597 P.2d 380 (1979). The Allison Court cites to Prima Paint as providing the controlling standard.

Here, Respondents have stated no challenge to the enforceability of either the arbitration provision or the LLC Operating Agreement. The resolution of the issue of whether the non-signatory Respondents would be bound to arbitrate turns, in part, on whether the signatory entities can be ignored. The resolution of the alter ego requires an examination of the course of performance of the operative agreements, also making this an issue for the Arbitrator under the FAA.

The claims here – that Respondents derived improper benefit through self-dealing and that the separate existence of the various business entities can be ignored – are not limited to the issue of the enforceability of the arbitration provision by itself. They encompass the whole course of performance by the Quiggs under the LP Agreement and later the LLC Operating Agreement. A Trial Court could not resolve the issue of arbitrability *without* litigating the entirety of the underlying dispute. Thus, the Trial Court's ruling, based on a substantive issue going to the course of performance of the operative agreements, is clearly inconsistent with the holdings in the cases cited above that issues going to the performance of the contract as a whole are for the Arbitrator under the FAA.

Accordingly, the Trial Court clearly exceeded its authority under the FAA, and this matter should have been compelled into arbitration as provided in the operative agreements.

B. Respondents' Summary Judgment Motion.

1. The Standard of Review.

The review a grant of summary judgment is *de novo* and the Appellate Court performs the same inquiry as the Trial Court. Sheikh v. Choe, 156 Wn.2d 441, 447, 128 P.3d 574 (2006). A Court views the evidence and all reasonable inferences therefrom in the light most favorable to the non-moving party. Michak v. Transnation Title Ins. Co., 148 Wn.2d 788, 794-95, 64 P.3d 22 (2003). Summary judgment is appropriate when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. CR 56(c); Michak, 148 Wn.2d at 794-95. "A material fact is one that affects the outcome of the litigation." Owen v. Burlington N. & Santa Fe JUL Co., 153 Wn.2d 780, 789, 108 P.3d 1220 (2005).

In this case, it would appear that the sole material fact on which Respondents' Motion was based was Appellant's status as a Member of LC. Respondents' Motion asserted that a Member of a limited liability company holds no claims separate from the limited liability company itself for misconduct of another Member of the limited liability company, as a matter of law.

2. The Trial Court's Resolution of the Standing Issue Was Simply Wrong.

The first fundamental problem with the argument that only LLC would have claims arising from the course of the Quiggs' conduct alleged in Appellant's Notice of Dispute (*CP 6-16 excluding exhibits*) is that Respondents offer no explanation whatsoever as to why, if Partners in a limited partnership or Members of a limited liability company have no claims against a General Partner or Member, both statutes specifically define the circumstances under which such claims may be asserted. The Limited Partnership Statute specifically provides that a General Partner in a limited partnership owes a limited fiduciary duty to the Limited Partners:

(1) The only fiduciary duties that a general partner has to the limited partnership and the other partners are the duties of loyalty and care under subsections (2) and (3) of this section.

(2) A general partner's duty of loyalty to the limited partnership and the other partners is limited to the following:

(a) To account to the limited partnership and hold as trustee for it any property, profit, or benefit derived by the general partner in the conduct and winding up of the limited partnership's activities or derived from a use by the general partner of limited partnership property, including the appropriation of a limited partnership opportunity;

(b) To refrain from dealing with the limited partnership in the conduct or winding up of the limited partnership's activities as or on behalf of a party having an interest adverse to the limited partnership; and

(c) To refrain from competing with the limited partnership in the conduct or winding up of the limited partnership's activities.

RCW 25.10.441.

The Limited Liability Company Statute also provides for liability of a Member or Manager to the Members:

(1) A member or manager shall not be liable, responsible, or accountable in damages or ... ***to the members of the limited liability company*** for any action taken or failure to act on behalf of the limited liability company ***unless such act or omission constitutes gross negligence, intentional misconduct, or a knowing violation of law.***

RCW 25.15.155 (*Emphasis added*). In short, the statute explicitly provides that a Manager may be held liable “to the members of the limited liability company” for “gross negligence, intentional misconduct or knowing violation of law.”

Both statutes likewise contain provisions specifying the circumstances under which a Limited Partner or a Member of a limited liability company can assert claims derivatively of the limited partnership (RCW 25.10.706) or limited liability company (RCW 25.15.370). So, the statutes clearly differentiate against claims which can be asserted by a Member against other Members and claims which can be asserted derivatively by a Member on behalf of the entity. There would be no reason to provide for Member versus Member claims if only the entity could assert claims based on wrongful conduct by a Member.

The second fundamental flaw in Respondents’ argument, and the fundamental mistake made by Respondents, is that they fail to draw a distinction between claims arising from the relationship between the entity and third parties, and claims between the Partners/Members arising from their dealings with each other. In this regard, Respondents cited to

Finlay v. Takasaki, 2006 WL 1169794 (USDC 2006), for the proposition that a claim against a Manager by a Member of a limited liability company is a derivative claim, assertable only by the company. (CP 459). In point of fact, the claims at issue in Finlay were *not* asserted against another Member of the limited liability company involved, Hawks Prairie Industrial Park LLC (“HPIP”). There were no claims that the Manager of HPIP had engaged in misconduct because the Manager was, in fact, the plaintiff Joseph Finlay.

Rather, Finlay in his capacity as a Member was attempting to individually assert claims arising from the dealings between HPIP and third parties, *against that third party*. As the Finlay Court noted:

Plaintiffs have no doubt shown, at least on the pleadings, that they suffered personal economic loss as a result of Defendants’ wrongdoing. This is insufficient, however, because their personal loss derives from their membership in the LLC. Shell Petroleum, 709 F.2d at 595; Real Marketing, 309 B.R. at 789; *see also Sparling*, 864 F.2d at 640; Sabey v. Howard Johnson & Co., 5 P.3d 730, 735 (Wash.Ct.App.200). Instead of a derivative loss, Plaintiffs must allege that they suffered an injury distinct from those of any other LLC member, or that there was a special relationship between themselves and the Defendants. Sparling, 864 F.2d at 640.

2006 WL 1169794 at 3. What the Finlay Court is saying is that, in order for a Member to assert a claim *against a third party based on dealings between the third party and the limited liability company*, the Member must allege either that the conduct of the third party has caused the Member damage separate and distinct from the damage caused to the limited

liability company, or “a special relationship” between the Member and the third party. Otherwise, only the entity has standing to assert claims.

This is stated explicitly in the Sabey case (101 Wn. App. 575) referenced by the Finlay Court:

As an exception to the general rule, a stockholder may maintain *an action* in his own right *against a third party* (although the corporation may likewise have a cause of action for the same wrong) when the injury to the individual resulted from violation of some special duty owed to the stockholder but only when that special duty had its origin in circumstances independent of the stockholder’s status as a stockholder.

101 Wn. App. 575 at 585 (*emphasis added*). There was no relationship – special, fiduciary or otherwise – between the individual members of HPIP and the development limited liability company/defendant in Finlay. Accordingly, there was no basis for Finlay to assert claims on his own behalf against third parties based on an injury to the limited liability company.

This is exactly what distinguishes Finlay from Bishop of Victoria Corp. Sole v. Corporate Business Park LLC, 138 Wn. App. 443 (2007). In Bishop of Victoria, one member of the limited liability company was suing the other member of the limited liability company for breach of fiduciary duty. The cause of action was based on the relationship between the Members of the limited liability company and not the relationship between the limited liability company and third parties. In defining the duty owed by one Member of a limited liability company to another Member, the Court stated:

While a member's obligation to contribute to the LLC arises from the parties' contractual agreements, a member's fiduciary duty arises by virtue of the parties trust relationship. An LLC manager is entitled to rely in good faith on other managers. The role of members in a member-managed LLC is analogous to that of partners in a general partnership, and partners are held accountable to each other and the partnership as fiduciaries.

Partners owe each other fiduciary duties and are obligated to deal with each other with candor and the utmost good faith. A partner owes a fiduciary duty of loyalty and care to both the partnership and to other partners. RCW 25.05.165. A partner owes a duty of loyalty to avoid secret profits, self-dealing, and conflicts of interest. RCW 25.05.165(2)(a)-(c). A partner must avoid self-dealing by refraining from dealing with the partnership on behalf of a party having an interest adverse to the partnership. RCW 25.05.165(2)(b). And a partner must avoid conflicts of interest in refraining from competing with the partnership. RCW 25.05.165(2)(c). ***A partner owes a duty of care to refrain from engaging in grossly negligent conduct, intentional misconduct, and knowing violations of law.*** RCW 25.05.165; also RCW 25.15.155.

Id. at 456-457 (*some citations omitted; emphasis added*). Clearly, if all causes of action for misconduct by a limited liability company Member were held by the limited liability company, the *Bishop of Victoria* Court could not have reached this result.

How this plays out here is as follows. Appellant is not seeking to recover the funds diverted from LP/LLC from the various Quigg-related entities to which those funds were diverted. The claims against those entities would clearly be a claim of LP/LLC. Rather, Appellant is seeking to recover for the loss of its investment from the Managers of LP/LLC whose intentional misconduct caused the loss. This is a claim recognized

explicitly in the statute which claim is separate and distinct from the claim of LLC both as to the parties and the measure of damages. Accordingly, the decision of the Trial Court on the standing issue was clearly in error and should be reversed.

C. Respondents' Evidentiary Motion.

1. Standard of Review.

The admission or refusal of evidence lies largely within sound discretion of Trial Court, and is reviewed under an abuse of discretion standard. *Maehren v. City of Seattle*, 92 Wn.2d 480, 599 P.2d 1255 (1979).

2. The Statements Stricken by the Trial Court were not Hearsay.

Respondents' Motion to Strike is CP 430-436. The specific objections appear at CP 431-434. In each case, Respondents objected to "allegations" in the "Dispute Notice" on the basis that the allegations are hearsay. Moreover, Respondents did not seek to have any portion of the Notice of Dispute itself stricken – only portions of Appellant's Motions which summarized the allegations.

The discussion of the allegations in the Notice of Dispute was not for the purpose of proving the truth of the factual assertions contained in the Notice of Dispute. Respondents have conceded (at CP 445) that the Trial Court's "discretion for compelling arbitration is...limited to a two-step process of 'determining (1) whether a valid agreement to arbitrate exists, and if it does; (2) whether the agreement encompasses the dispute at issue,' " citing to *Chiron Corp. v. Ortho Diagnostics Systems, Inc.*, 207 F.3d 1126 at 1130 (9th Cir. 2000). Obviously, in order for the Trial

Court to make a determination as to whether the dispute falls within the scope of disputes which the parties have agreed to arbitrate, the Trial Court would have to be provided with information regarding the nature of the dispute.

It is hornbook law that statements not offered to prove the truth of the matter asserted are not hearsay. Here, the information offered to the Trial Court was not offered to prove that Respondents violated fiduciary or other duties owed to Appellant – it was offered to show that the dispute involved a claim of such a breach. Accordingly, the Trial Court’s Order was clearly an abuse of discretion.

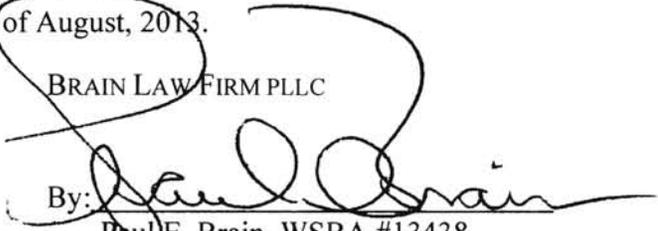
V. CONCLUSION

Rather than ruling on Respondents’ Motion for Summary Judgment, the Trial Court should have granted Appellant’s Motion to Compel Arbitration. Accordingly, Appellant respectfully requests that this Court remand the matter to the Trial Court with direction to vacate the Order Granting Summary Judgment and enter an Order Compelling Arbitration.

Appellant also respectfully requests that this Court direct the Trial Court to vacate its Order Granting Respondent’s Motion to Strike.

DATED this 12th day of August, 2013.

BRAIN LAW FIRM PLLC

By: 

Paul E. Brain, WSBA #13438

Counsel for Appellant

CERTIFICATE OF SERVICE

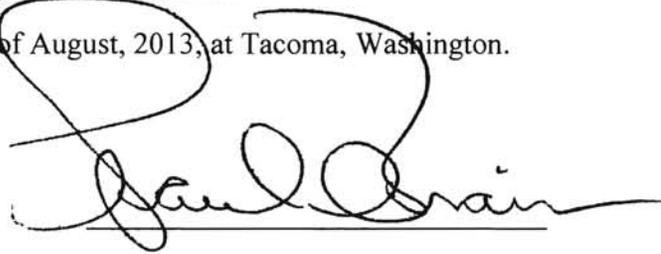
I hereby certify that I have this 12th day of August, 2013, served a true and correct copy of the foregoing document upon counsel of record, via the methods noted below, properly addressed as follows:

Counsel for Respondents

John M. Kreutzer	<input checked="" type="checkbox"/>	Hand Delivery
Brian K. Weeks	<input type="checkbox"/>	U.S. Mail (first-class, postage prepaid)
Smith Freed & Eberhard P.C.	<input type="checkbox"/>	Facsimile
111 SW Fifth Avenue, Suite 4300	<input type="checkbox"/>	Email
Portland, OR 97204		

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 12th day of August, 2013, at Tacoma, Washington.



BY _____
DEPUTY

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STATE OF WASHINGTON
COURT OF APPEALS
DIVISION II