

50247-0-II

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

WILLIAM NEWCOMER,
Respondent,

v.

MICHAEL COHEN, et al.
Appellant.

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RESPONDENT WILLIAM NEWCOMER'S BRIEF

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TABLE OF CONTENTS

I. INTRODUCTION 1

II. STATEMENT OF THE CASE..... 3

 A. Cohen sold securities to Newcomer..... 3

 B. A jury found Cohen committed securities fraud..... 5

 C. This Court affirmed the judgment and all trial court orders in the Securities Case 6

 D. Newcomer personally loaned Cohen \$600,000 in a separate transaction from the capital contributions to the Apex Entities..... 7

 E. Newcomer filed the underlying lawsuit to collect on the Promissory Note..... 9

III. ARGUMENT..... 10

 A. Because Cohen violated the WSSA, the LLC Agreements entered into in violation of it cannot be enforced against Newcomer..... 10

 1. A contract entered into in violation of the WSSA cannot be enforced against the defrauded party 10

 2. Washington courts enforce the plain language of the WSSA..... 11

 3. Other jurisdictions applying the Uniform Securities Act reach the same conclusion as the Washington Supreme Court – a party that has violated the Securities Act may not enforce a contract made in violation of the Act..... 13

 4. If this Court finds RCW 21.20.430(5) ambiguous, it must interpret the statute broadly to protect Newcomer..... 15

 5. Cohen’s interpretation of the statute ignores applicable rules of statutory construction and creates absurd results..... 16

 6. The mere change in entity form cannot cure Cohen’s adjudicated, underlying fraud 17

 B. RCW 21.20.430(5) is operative upon a finding of a violation of the WSSA. It is not necessary that the defrauded party is awarded rescission 18

- C. Even if RCW 21.20.430(5) requires rescission, Cohen cannot enforce the LLC Agreements against Newcomer because the jury awarded recessionary damages..... 19
 - 1. In restoring the parties to their pre-contract state, the jury awarded recessionary damages..... 19
 - 2. Newcomer tendered the securities, divesting himself of any interest in the Apex Entities..... 20
 - 3. Even if Newcomer didn't own the securities at the time of the tender, courts still apply a recessionary measure of damages 23
- D. The trial court found the Apex LLC Agreements void as to Newcomer only 24
- E. Newcomer did not waive his right to assert RCW 21.20.430(5)..... 25
 - 1. The parties briefed and argued the application of RCW 21.20.430(5)..... 26
 - 2. By statute, Newcomer cannot waive RCW 21.20.430(5)..... 27
 - 3. Cohen moved to stay proceedings while Newcomer's motion to amend his answer to the counterclaim remains outstanding 28
- F. Even if this Court rejects RCW 21.20.430(5), the Apex LLC Agreements are still voidable by Newcomer as a result of Cohen's fraud 29
- G. The trial court properly requested additional briefing on a briefing schedule that allowed the parties to respond 30
- H. In the alternative, this Court may affirm the trial court based upon on the unambiguous language of the LLC Agreements which makes further contribution permissive but not mandatory, relieving Newcomer of any further capital call obligation 32
- I. Newcomer is entitled to an award of attorney's fees in this appeal 35
- IV. CONCLUSION..... 36

TABLE OF AUTHORITIES

CASES

<i>Angelo Prop. Co., LP v. Hafiz</i> , 167 Wn. App. 789, 823, 274 P.3d 1075 (2012).....	28
<i>Bickford v. City Of Seattle</i> , 104 Wn. App. 809, 813, 17 P.3d 1240 (2001).....	26
<i>Bldg. Indus. Ass'n of Washington v. McCarthy</i> , 152 Wn. App. 720, 743, 218 P.3d 196 (2009).....	31
<i>Bloor v. Fritz</i> , 143 Wn. App. 718, 740, 180 P.3d 805 (2008).....	29, 30
<i>CalPortland Co. v. LevelOne Concrete LLC</i> , 180 Wn. App. 379, 394, 321 P.3d 1261 (2014).....	26
<i>Cellular Eng'g, Ltd. v. O'Neill</i> , 118 Wn.2d 16, 820 P.2d 941, 943 (1991).....	12, 13
<i>Christensen v. Grant Cty. Hosp. Dist. No. 1</i> , 152 Wn.2d 299, 306, 96 P.3d 957 (2004).....	21
<i>Connecticut Nat. Bank v. Giacomi</i> , 242 Conn. 17, 67, 699 A.2d 101, 128 (1997).....	14
<i>Criticare Sys., Inc. v. Sentek, Inc.</i> , 159 Wis. 2d 639, 652, 465 N.W.2d 216 (Wis. Ct. App. 1990).....	14
<i>Dewey v. Tacoma Sch. Dist. No. 10</i> , 95 Wn. App. 18, 26, 974 P.2d 847 (1999).....	27
<i>Garmo v. Dean, Witter, Reynolds, Inc.</i> , 101 Wn.2d 585, 588, 681 P.2d 253 (1984).....	17
<i>Go2Net, Inc. v. Freeyellow.com, Inc.</i> , 126 Wn. App. 769, 783, 109 P.3d 875, 881 (2005), <u>aff'd</u> , 158 Wn.2d 247, 143 P.3d 590 (2006).....	19
<i>Golberg v. Sanglier</i> , 96 Wn.2d 874, 887 n. 5, 639 P.2d 1347 (1982), <i>amended</i> , 96 Wn.2d 874, 647 P.2d 489 (1982).....	12
<i>Grant Cty. Port Dist. No. 9 v. Washington Tire Corp.</i> , 187 Wn. App. 222, 235, 349 P.3d 889 (2015).....	34
<i>Gronquist v. State</i> , 177 Wn. App. 389, 396 n. 8, 313 P.3d 416 (2013).....	34
<i>Harting v. Barton</i> , 101 Wn. App. 954, 962, 6 P.3d 91 (2000).....	27
<i>Helenius v. Chelius</i> , 131 Wn. App. 421, 431, 120 P.3d 954 (2005).....	11, 15, 19
<i>Hines v. Data Line Sys., Inc.</i> , 114 Wn.2d 127, 135, 787 P.2d 8, 13 (1990).....	20

<i>Hoover v. Warner</i> , 189 Wn. App. 509, 526, 358 P.3d 1174 (2015), review denied, 185 Wn.2d 1004, 366 P.3d 1243 (2016)	34
<i>In re Bonham</i> , 229 B.R. 438, 442 (Bankr. D. Alaska 1999).....	14
<i>In re Marriage of Giordano</i> , 57 Wn. App. 74, 78, 787 P.2d 51 (1990)	31
<i>Ito Int'l Corp. v. Prescott, Inc.</i> , 83 Wn. App. 282, 288, 921 P.2d 566 (1996).....	17
<i>Kinney v. Cook</i> , 159 Wn.2d 837, 842, 154 P.3d 206 (2007).....	30
<i>La Fray v. City of Seattle</i> , 12 Wn.2d 583, 588, 123 P.2d 345 (1942)	25
<i>Monetary Mgmt. of St. Louis, Inc. v. Kidder</i> , 604 F. Supp. 764, 768 (E.D. Mo. 1985)	21
<i>Newcomer v. Cohen</i> , 199 Wn. App. 1003, 2017 WL 2154358 (2017) (unpublished).....	1, 3, 7, 19
<i>Pinkis v. Network Cinema Corp.</i> , 9 Wn. App. 337, 340, 512 P.2d 751 (1973).....	29
<i>Randall v. Loftsgaarden</i> , 478 U.S. 647, 655, 106 S. Ct. 3143, 3149, 92 L. Ed. 2d 525 (1986)	23
<i>Securities America, Inc. v. Rogers</i> 850 So. 2d 1252, 1258 (Ala. 2002).....	14
<i>United Glass Workers' Local No. 188 v. Seitz</i> , 65 Wn.2d 640, 642, 399 P.2d 74 (1965).....	34
<i>Wigand v. Flo-Tek, Inc.</i> , 609 F.2d 1028, 1035 (2d Cir. 1979).....	20
<i>Windswept Corp. v. Fisher</i> , 683 F. Supp. 233, 239 (W.D. Wash. 1988).....	22
<i>Winston v. State/Dep't of Corr.</i> , 130 Wn. App. 61, 65, 121 P.3d 1201 (2005).....	31
<i>Yakima Cty. (W. Valley) Fire Prot. Dist. No. 12 v. City of Yakima</i> , 122 Wn.2d 371, 390, 858 P.2d 245 (1993)	29

STATUTES

15 USC § 771.....	21, 23
RCW 21.20.430	passim
RCW 21.20.010	6, 13
RCW 25.15.154(1).....	16
RCW 25.15.006(7).....	30
RCW 2.28.010.....	31
RCW 2.28.150.....	32

ALA. CODE § 8-6-19 (2002)	13, 14
ALASKA STAT. § 455.55.930 (1959).....	13, 14
Wis. STAT. § 551.59 (1990).....	13, 14
Former CONN. GEN. STAT. § 36b-29 (2010)	13, 14

RULES

CR 12(b).....	26
CR 54(b).....	28
CR 56(f)	31
CR 56(c).....	31
RAP 18.1.....	35

OTHER AUTHORITIES

Francis C. Amendola, <i>et al.</i> , <i>Contracts as Void or Voidable</i> , 69A Am. Jur. 2d Securities Regulation-Federal § 873.....	15
23:6.Contract voidance, 26A Sec. Lit. Damages § 23:6.....	15
WAC 458-61A-211	16
Elizabeth Chamblee Burch, <i>Reassessing Damages in Securities Fraud Class Actions</i> , 66 Md. L. Rev. 348, 373 (2007)	23
RESTATEMENT (SECOND) OF CONTRACTS §164(1).....	29

I. INTRODUCTION

Michael Cohen committed securities fraud in connection with the sale of over \$2.3 million in membership interests in LLCs to William Newcomer. Now, Cohen seeks to do it again through the very same LLCs, subverting this Court's decision in *Newcomer v. Cohen*, 199 Wn. App. 1003, 2017 WL 2154358 (2017) (unpublished).

In 2014, Newcomer sued Cohen for violations of the Washington State Securities Act, RCW 21.20, ("WSSA"). That lawsuit (the "Securities Case"), concerned misrepresentations and omissions Cohen made in connection with four separate sales of securities from Cohen to Newcomer in the form of membership interest in the LLCs ("the Apex Entities").

In advance of judgment, Newcomer tendered his interest in all Apex Entities. The jury found that Cohen violated the WSSA in connection with all four sales of securities from Cohen to Newcomer. As required under the WSSA, the jury returned the parties to their pre-contract state by awarding Newcomer the entire amount he paid in capital contributions for the securities.

In 2010, as a separate transaction from the sale of securities, Newcomer loaned Cohen \$600,000, secured by a promissory note ("the Promissory Note"). Cohen is the maker of the Promissory Note in his

individual capacity. In addition to Cohen, two of the Apex Entities are also makers of the note with joint and several liability.

The Promissory Note was not due at the time of trial in the Securities Case and Newcomer did not make a claim for breach of the Promissory Note in that lawsuit. The Promissory Note became due in November 2015 and the makers failed to pay. Newcomer then filed the underlying lawsuit to recover on the Promissory Note.

In response, Cohen and the Apex Entities, through Cohen as their manager, filed counterclaims seeking to enforce a fifth capital call of Apex Apartments, LLC to attempt to offset the liability on the Promissory Note. The fifth capital call is tainted with the same fraud as the first four. Had Cohen sought to enforce this fifth capital call at the time of the Securities Case, it would have been included in the Securities Case.

The Legislature directly addressed this issue and specifically prohibits enforcement of a contract entered into in violation of the WSSA against the defrauded party.

The trial court's decision and order granting Newcomer's motion for partial summary judgment properly applies the law to the undisputed facts to conclude that Newcomer has no obligation for capital call requirements under the Apex Entity LLC Agreements.

II. STATEMENT OF THE CASE

Newcomer adopts the facts recited by this Court in *Newcomer v. Cohen*, 199 Wn. App. 1003, 2017 WL 2154358 (2017) (unpublished). For ease of reference, brief relevant facts related to the Securities Case are below, together with the additional facts related to the Promissory Note that is the subject of the immediate case.

A. Cohen sold securities to Newcomer.

In late 2004, Cohen approached Newcomer with a proposal to invest in the Apex Apartments, a residential development near the Tacoma Mall. Cohen proposed that he and other investors would contribute cash to form Apex Apartments, LLC (“Apex I”). CP 104. Throughout the project, Cohen formed additional LLCs to hold separate phases of the project. Apex Apartments II, LLC (“Apex II”) was formed to hold a second phase building, and Apex Penthouse Condos, LLC (“Apex Condos”) was formed to hold condominium units. CP 159.

Cohen also formed Apex Apartments I TIC, LLC (“Apex TIC”) and Newcomer Apex TIC, LLC (“Newcomer TIC”) so that the real property owned by Apex I could be held as tenants in common. CP 191, CP 225. Newcomer withdrew from Apex I and transferred his interest to Newcomer TIC, and all other members withdrew from Apex I and transferred their interest to Apex TIC. CP 158. Newcomer is not, and has

never been, a member of Apex TIC. Cohen has always been the manager of all Apex Entities. All Apex Entities were the subject of the Securities Case.

Cohen made four distinct capital calls, which constituted four separate sales of securities – a 2005 sale in the amount of \$800,000, a 2006 sale in the amount of \$272,997, a 2008 sale in the amount of \$326,555, and a 2009 sale in the amount of \$910,000. CP 1098. The total value of securities Cohen sold Newcomer was \$2,309,552.

Despite the fact that Cohen had created multiple Apex LLCs to hold various aspects of the project, each of the above capital calls were made on behalf of Apex Apartments, LLC only. CP 132 (2005 \$800,000 capital call), CP 991-992 (2006 \$272,997 capital call), CP 993-994 (2008 \$326,555 capital call), CP 995-998 (2009 \$910,000 capital call). It is further undisputed that Newcomer's checks for each of the above capital calls were deposited in an account owned by Apex Apartments, LLC. CP 2152-2163.

On April 30, 2014, after Newcomer filed the Securities Case but before trial, Cohen sold the entire Apex Apartment project to a third party. All bank loans were paid off, but Newcomer did not receive any return on his investment. CP 607. After the sale, none of the Apex Entities held any revenue generating assets.

B. A jury found Cohen committed securities fraud.

Cohen's scheme in promoting the Apex project was based on a series of misrepresentations and omissions that enriched Cohen at the expense of all other investors.

Cohen convinced Newcomer to make an initial capital contribution in the amount of \$800,000 in cash on the express representation that Cohen would do the same. Newcomer did as he agreed and made an \$800,000 initial cash contribution, but Cohen's promise was a lie. Cohen repeatedly said he contributed \$800,000 in cash, but he did not.

As a result of Cohen's failure to contribute to Apex as agreed, the entity was underfunded. To attempt to cover up his failure to contribute to the entity as agreed, Cohen secretly obligated Apex to borrow money from Point Ruston, LLC ("Point Ruston"). Point Ruston is an entity controlled by Cohen, and Newcomer is not a member of it. Without disclosing the debt to Newcomer, Cohen sought additional capital contributions from Newcomer.

In addition, Cohen paid himself with Apex assets without disclosure. While the Apex Apartments, LLC Agreement allowed Cohen a fee of 10% of the hard costs of construction as a management fee, without disclosure to Newcomer, Cohen obligated the Apex project to pay Cohen

an additional \$400,000 for “founding and organizing” the opportunity. CP 149.

On January 13, 2014, after Newcomer discovered that Cohen had continually lied about fundamental aspects of the investment, Newcomer brought a lawsuit against Cohen alleging a WSSA violation. CP 670. In advance of judgment, Newcomer tendered his entire interest in all Apex Entities to Cohen. CP 1095. Thereafter, the jury returned a verdict specifically finding that Cohen violated the WSSA in connection with each of the four sales of securities from Cohen to Newcomer. CP 1098. That verdict returned the parties to their pre-contract state by awarding Newcomer the entire amount he paid for the securities. CP 1098.

On October 9, 2015, the trial court entered judgment on the verdict. The judgment also awarded pre-judgment interest and attorney’s fees. The face of the judgment specifically provides “This judgment is based on a finding of a violation of RCW 21.20.010 and RCW 21.20.430.” CP 1111.

C. **This Court affirmed the judgment and all trial court orders in the Securities Case.**

Cohen appealed from the sufficiency of the evidence presented to the jury in the Securities Case. This Court held there was sufficient evidence to support the jury’s verdict and affirmed the judgment and all

trial court orders. *Newcomer v. Cohen*, 199 Wn. App. 1003, 2017 WL 2154358 (2017) (unpublished).

This Court's opinion contains a detailed and accurate recitation of the factual and procedural history of the Securities Case. Directly relevant to the immediate appeal, this Court acknowledged that in the Securities Case the jury "awarded Newcomer recessionary damages of \$2,309,552—the total amount in capital contributions he made to the Apex project." *Id.* (emphasis added).

D. Newcomer personally loaned Cohen \$600,000 in a separate transaction from the capital contributions to the Apex Entities.

Newcomer's final capital contribution to the Apex Entities was made in July 2009, bringing his total capital contributions \$2,309,552. CP 2164.

In February 2010, in a separate, unrelated transaction, Cohen asked Newcomer if Newcomer would make a short-term loan to Point Ruston in the amount of \$200,000. At this point, Newcomer had not yet discovered the fraud committed by Cohen in connection with the sale of securities. CP 1050. Newcomer is not and has never been a member of Point Ruston.

The loan was for Point Ruston – and not the Apex Entities – and was evidenced by the Promissory Note, personally guaranteed by Cohen. The loan was due in full by May 10, 2010. CP 1152.

Point Ruston and Cohen did not pay the \$200,000 promissory note by the due date. In July 2010, Cohen asked Newcomer for an additional loan to be made to Cohen personally in the amount of \$600,000. Cohen indicated that this loan would be used in part to pay off the \$200,000 Point Ruston loan. Cohen represented it would be a short-term loan, and in order to entice Newcomer to make the loan, Cohen offered an increased interest rate and indicated he would offer security in addition to the assets in his name personally. Cohen indicated he had authority to offer security from Apex TIC (of which Newcomer was not a member), as well as Apex Condos, which held unsold real estate in the form of condominium units. CP 1155.

In October 2010, Newcomer agreed to Cohen's proposal on the condition that a portion of the \$600,000 be used to immediately repay the \$200,000 Point Ruston debt plus interest. Newcomer still did not have knowledge of the fraud committed by Cohen in connection with the sale of securities. CP 1051.

On November 1, 2010, Newcomer loaned Cohen the agreed \$600,000 and Cohen executed the Promissory Note together with Apex TIC and Apex Condos. CP 1055-1058. After receiving the \$600,000, Cohen repaid Point Ruston's debt using a portion of the \$600,000 loan from Newcomer. This resulted in satisfying the \$200,000 February 2, 2010 Point Ruston

promissory note. The \$600,000 November 1, 2010 Promissory Note became due in full on November 1, 2015. No payments whatsoever have been made on the Promissory Note. CP 1051.

E. Newcomer filed the underlying lawsuit to collect on the Promissory Note.

On January 21, 2016, Newcomer filed the underlying lawsuit to collect on the unpaid Promissory Note in Pierce County Superior Court. CP 1. Cohen, individually, and the Apex Entities, managed by Cohen sought to offset the debt by alleging that the Apex Entities, which were the subject of the Securities Case and securities fraud judgment could make a capital call to Newcomer to offset the debt on Cohen's Note. CP 49.

On December 23, 2016, January 6, 2017, and January 9, 2017, the Honorable Stanley J. Rumbaugh heard motions for partial summary judgment related to whether Apex could compel Newcomer to make an additional capital contribution that may be used to offset the Promissory Note liability. At the January 9, 2017 hearing, the trial court called for additional briefing, which was provided on a schedule agreed to by the parties. The trial court heard argument related to the additional briefing on January 27, 2017, and took the matter under advisement. On February 14, 2017, the trial court issued a written decision on the motions for partial summary judgment finding that as a result of Cohen's violation of the

WSSA, no Apex Entity capital contribution can be enforced against Newcomer. CP 2595-2599. The trial court entered an order granting Newcomer's motion for partial summary judgment on that issue on February 24, 2017. CP 2600-2608. Cohen, individually, and Apex through Cohen as manager, seek review of the February 14, 2017 decision and February 24, 2017 order.

III. ARGUMENT

A. **Because Cohen violated the WSSA, the LLC Agreements entered into in violation of it cannot be enforced against Newcomer.**¹

1. **A contract entered into in violation of the WSSA cannot be enforced against the defrauded party.**

The WSSA protects Newcomer against exactly what Cohen attempted to do. The plain language of RCW 21.20.430(5) states, in part:

No person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any suit on the contract.

RCW 21.20.430(5).

RCW 21.20.430(5) consists of two parts. First, it requires a finding that a "person... made or engaged in the performance of [a] contract in

violation of [WSSA]" or the person "acquired... [a] purported right under... such contract with knowledge... [of the violation]." Second, if the court finds requisite culpability then the party in contractual privity cannot "base any suit on the [offending] contract."

Without question, the jury in the Securities Case found Cohen violated the WSSA thereby satisfying the first element required to invoke RCW 21.20.430(5). Cohen violated WSSA when he fraudulently induced Newcomer to invest in the Apex Entities. Cohen controlled each and every Apex related LLC. Thus, Cohen's form-over-function arguments fail because the entities "acquired" the "purported right" to capital calls with knowledge of Cohen's fraud. Accordingly, Cohen cannot now "base any suit" on the contract entered into in violation of the WSSA. It is undisputed that the Apex Apartments LLC Agreement is a contract and was entered into in violation of the WSSA. Therefore, Newcomer cannot be compelled to make an additional capital contribution.

2. Washington courts enforce the plain language of the WSSA.

Washington appellate courts interpret RCW 21.20.430(5) to deprive a wrongdoer from reaping the benefits of their wrongful conduct.

¹ Appellate review of the order granting Newcomer's motion for partial summary judgment as well as the statutory interpretation of the WSSA is de novo. *Helenius v. Chelius*, 131 Wn. App. 421, 431, 120 P.3d 954 (2005).

In *Golberg v. Sanglier*, 96 Wn.2d 874, 887 n. 5, 639 P.2d 1347 (1982), *amended*, 96 Wn.2d 874, 647 P.2d 489 (1982), our Supreme Court found RCW 21.20.430(5) “coextensive with the rule of in pari delicto.” By extension, the Court reasoned RCW 21.20.430(5) embodied “public policy considerations.... intended to prevent the guilty party from reaping the benefit of his wrongful conduct.” *Id.* at 884 (citations and quotes omitted; emphasis added).

In *Cellular Eng'g, Ltd. v. O'Neill*, 118 Wn.2d 16, 820 P.2d 941, 943 (1991), our Supreme Court considered a case with facts very similar to the immediate case. In that case, Cellular sold securities to O’Neill in the form of an Application Purchase Agreement. *Id.* at 19. Cellular violated the WSSA with respect to the Application Purchase Agreement and O’Neill refused to pay his obligations under the terms of the contract. *Id.* at 21. Cellular then brought suit to enforce the contract. *Id.* at 21. The Court held that as a result of the finding of a violation of WSSA, the Application Purchase Agreement made in violation of WSSA could not be enforced. *Id.* at 36. The Court explained:

[T]he Application Purchase Agreement between Cellular and its customers—being an integral part of Cellular’s activities—were made in violation of the registration provision. Under RCW 21.20.430(5), “[n]o person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder ... may base any suit on the contract.”

Therefore, Cellular may not base any suit on its Application Purchase Agreement with O'Neill.

Id. at 37.

Here, the plain language of RCW 21.20.430(5) and clear directive from the *Cellular* court prohibits enforcement of the LLC Agreements against Newcomer. On the special verdict form, the jury specifically found Cohen violated the WSSA with respect to every single sale of securities to Newcomer. The face of the judgment entered in the Securities Case specifically provides, “This judgment is based on a finding of a violation of RCW 21.20.010 and RCW 21.20.430.” Therefore, the restriction of RCW 21.20.430(5) applies and Cohen cannot base any suit on the contractual LLC Agreement.

3. Other jurisdictions applying the Uniform Securities Act reach the same conclusion as the Washington Supreme Court – a party that has violated the Securities Act may not enforce a contract made in violation of the Act.

WSSA “is modeled after the Uniform Securities Act of 1956.” *Cellular*, 118 Wn.2d at 23. Other jurisdictions with securities statutes modeled after the Uniform Securities Act provide additional guidance.¹

¹ The Alabama Securities Act (ALA. CODE § 8-6-19 (2002)), the Connecticut Uniform Securities Act (Former CONN. GEN. STAT. § 36b-29 (2010)), the Alaska Securities Act (ALASKA STAT. § 455.55.930 (1959)), and the Wisconsin Uniform Securities Law (WIS. STAT. § 551.59 (1990)) are modeled on Uniform Securities Act and mirror the WSSA. Copies of each statute were provided to the trial court and are part of the record at CP 2350-2399.

Those courts reach the same conclusion as our Supreme Court – a party that has violated the Securities Act cannot enforce a contract entered into in violation of the Act.

The Alabama Supreme Court held that a party who had violated the Securities Act could not enforce a contract entered into in violation of the Act. Although the defrauding party, SAI, argued “it had no knowledge of any violation of the [Securities] Act,” the court rejected the argument and voided the contract noting, “The violations of the Alabama Securities Act rendered the SAI [contract] unenforceable by SAI. Therefore, SAI is not entitled to seek arbitration under the provisions of those agreements.” *Securities America, Inc. v. Rogers* 850 So. 2d 1252, 1258 (Ala. 2002).

The Connecticut Supreme Court held that a party that violated the Securities Act could not sue for money owed on a contract entered into in violation of the Act even though the contract was valid on its face noting one who violates the Act should not be able to “reap the rewards of the contract—albeit facially valid—that constituted a principal [violation of the Act].” *Connecticut Nat. Bank v. Giacomi*, 242 Conn. 17, 67, 699 A.2d 101, 128 (1997). *See also In re Bonham*, 229 B.R. 438, 442 (Bankr. D. Alaska 1999) (“person who makes a contract in violation of the Alaska Securities Act of 1959 may not base suit on the contract”); *Criticare Sys., Inc. v. Sentek, Inc.*, 159 Wis. 2d 639, 652, 465 N.W.2d 216 (Wis. Ct. App.

1990) (Wisconsin securities law prevents the party that violated the law “from maintaining a cause of action based upon the contract.”).

Objective secondary sources such as Kaufman on Securities and American Jurisprudence also support this clear rule: “a party to a contract who has made the contract ... in violation of the 1934 [Securities] Act or rules promulgated under it cannot enforce the contract against an unwilling innocent party.” 23:6.Contract voidance, 26A Sec. Lit. Damages § 23:6. *See also* 69A Am. Jur. 2d Securities Regulation-Federal § 873.

4. If this Court finds RCW 21.20.430(5) ambiguous, it must interpret the statute broadly to protect Newcomer.

Even if the Court found RCW 21.20.430(5)’s plain language ambiguous, this Court must resolve the ambiguity in Newcomer’s favor. “WSSA is a remedial statute” with a “primary purpose... to protect investors from speculative or fraudulent schemes of promoters.” *Helenius*, 131 Wn. App. at 432. Washington “courts construe the WSSA broadly to effectuate its intent” to protect investors. *Helenius*, 131 Wn. App. at 432.

WSSA fails its essential purpose if this Court interprets RCW 21.20.430(5) in the manner proffered by Cohen. A defrauded investor should bear no further liability to the defrauding party or his controlled entities when all entities relate to a single transaction.

5. Cohen's interpretation of the statute ignores applicable rules of statutory construction and creates absurd results.

Cohen's interpretation misconstrues WSSA's intent and ignores other, relevant WSSA provisions. For instance, Cohen argues, absent adjudication of misconduct by Newcomer TIC or Apex Condos, RCW 21.20.430(5) cannot apply. Cohen Br. at 34-38.

First, Cohen's form-over-function argument would allow a defrauding party to avoid liability by merely creating a successor entity. Creation of the subsequent entities here did not alter the primary transaction. For instance, Apex Apartments transferred its sole asset, in part, to Newcomer TIC. At the time of transfer, Cohen invoked WAC 458-61A-211(2)(b) to avoid potential excise tax. WAC 458-61A-211(2) only applies to "[a] mere change in form or identity where no change in beneficial ownership has occurred." Such a construction defeats WSSA's "remedial" purpose of protecting investors.

Second, a manager-managed LLC acts through its managers. RCW 25.15.154(1). Undisputedly, Cohen solely managed all of the Apex Entities. Cohen perpetuated the fraud and controlled the entities which controlled Newcomer's investment at all times.

Third, WSSA contemplates recovery against the defrauding person or defrauding entities' control person. To wit, WSSA imposes liability

upon “[e]very person who directly or indirectly controls a seller or buyer.” RCW 21.20.430(3). Because WSSA contemplates judgment against a real person, Newcomer need not show fraudulent conduct by an entity.

6. The mere change in entity form cannot cure Cohen’s adjudicated, underlying fraud.

Cohen also suggests that Newcomer’s agreement to change the structure of the Apex venture cured, or otherwise rendered, the subsequent LLC Agreements enforceable. Cohen Br. at 34. This change in entity form does not ratify the fraudulent conduct.

Applicable here, RCW 21.20.430(5) states in part, “Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.” “The WSSA states that any provision binding a person acquiring a security to waive compliance with the statute is void.” *Ito Int’l Corp. v. Prescott, Inc.*, 83 Wn. App. 282, 288, 921 P.2d 566 (1996); see also *Garmo v. Dean, Witter, Reynolds, Inc.*, 101 Wn.2d 585, 588, 681 P.2d 253 (1984).

As a matter of law, Newcomer cannot waive the protections afforded to him by WSSA. Therefore, even if Newcomer requested a change to the Apex holdings, which included the creation of subsequent entities, the underlying fraud remains.

B. RCW 21.20.430(5) is operative upon a finding of a violation of the WSSA. It is not necessary that the defrauded party is awarded rescission.

Cohen and the Apex Entities spend considerable portions of their respective opening briefs arguing that Newcomer did not receive the remedy of rescission in the Securities Case. Cohen Br. at 22-26; Apex Br. at 31-33. However, this analysis is irrelevant to the application of RCW 21.20.430(5) as it is undisputed that Cohen violated the WSSA. Moreover, this Court rejected that very same contention in Cohen's appeal in the Securities Case.

This interpretation also comports with the remainder of RCW 21.20.430. RCW 21.20.430 allows an aggrieved investor to recover: (1) the consideration paid, with interest, for the offending securities, or (2) damages if the investor no longer owns the securities. *See also* RCW 21.20.430(2) (providing similar remedies of rescission or damages for an aggrieved seller). Though RCW 21.20.430(1) and (2) set forth specific remedies, RCW 21.20.430(5) imposes no requirement that the aggrieved party receive one of the enumerated remedies to invoke operation of RCW 21.20.430(5). Logically, therefore, if an investor receives either remedy, RCW 21.20.430(5) applies and a contract entered into in violation of the WSSA cannot be enforced.

Additionally, consideration of the policy behind WSSA recognizes the futility of Cohen's argument. The Legislature enacted WSSA to protect investors. *Helenius*, 131 Wn. App. at 432. Respectfully, WSSA fails the Legislature's essential purpose if the investor must receive rescission instead of damages, or vice versa, to avoid subsequent enforcement of the contract tainted with fraud.

C. **Even if RCW 21.20.430(5) requires rescission, Cohen cannot enforce the LLC Agreements against Newcomer because the jury awarded recessionary damages.**

1. In restoring the parties to their pre-contract state, the jury awarded recessionary damages.

The face of the special verdict form and this Court's discussion of it make clear rescission was awarded. As this Court stated in its opinion in the Securities Case:

On September 21, 2015, the jury entered a special verdict in Newcomer's favor. It awarded Newcomer recessionary damages of \$2,309,552—the total amount in capital contributions he made to the Apex project.

Newcomer v. Cohen, 199 Wn. App. 1003, 2017 WL 2154358 (2017) at *6 (unpublished) (emphasis added).

This reading is consistent with the intent of the statute. "The statute provides the clean and surgical remedy of rescission as the sole recourse for an investor who proves a violation." *Go2Net, Inc. v. Freeyellow.com*,

Inc., 126 Wn. App. 769, 783, 109 P.3d 875, 881 (2005), affd., 158 Wn.2d 247, 143 P.3d 590 (2006).

“RCW 21.20.430(1) provides rescission as the basic remedy” for a violation of the Securities Act. *Hines v. Data Line Sys., Inc.*, 114 Wn.2d 127, 135, 787 P.2d 8, 13 (1990); *see also Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1035 (2d Cir. 1979) (“Section 12(2) [of the Federal Securities Act] is explicit in allowing the plaintiff no choice of remedy. If plaintiff owns the stock, he is entitled to rescission but not damages.”).

2. Newcomer tendered the securities, divesting himself of any interest in the Apex Entities.

Cohen and Apex attempt to imply that Newcomer did not tender his interest in the Apex Entities. This argument is dishonest and frivolous.

On September 8, 2015, in advance of judgment, Newcomer tendered his entire interest in all Apex Entities to Cohen as required under the WSSA. CP 1095. The tender letter was before the trial court when it considered the underlying motion and issued its order on summary judgment.

Newcomer’s tender was both on his individual behalf and on behalf of 2009 Newcomer Family, LLC (“Newcomer Family LLC”), an entity he controlled that held some of the securities. Whether Newcomer held his interest in the Apex Entities in his individual capacity or through

Newcomer Family LLC is not material as Newcomer possessed control of the securities sufficient to tender the securities as required by the WSSA.

Applying the federal Securities Act¹, the rule is succinctly explained:

Obviously, the reason that a non-owner is limited to a damage remedy is that a non-owner cannot tender the security back to the defendant and thereby accomplish rescission. In the opinion of this Court, a purchaser is an owner for purposes of § 12(2) if said purchaser possesses sufficient control or authority to effectuate a tender of the securities in question. Elusive notions of legal, equitable, or beneficial title should not be controlling in a § 12(2) case. The case at bar is a striking illustration of how such notions can unnecessarily complicate a factually simple case.

...

Accordingly, this Court holds that the touchstone is whether plaintiff has sufficient indicia of ownership to effectuate a tender of the securities in question if it were to prevail on the merits of its right to rescission.

Monetary Mgmt. of St. Louis, Inc. v. Kidder, 604 F. Supp. 764, 768 (E.D. Mo. 1985) (emphasis added).

Moreover, collateral estoppel precludes Cohen's argument that Newcomer did not tender the securities. "Collateral estoppel, or issue preclusion, bars relitigation of an issue in a subsequent proceeding involving the same parties." *Christensen v. Grant Cty. Hosp. Dist. No. 1*, 152 Wn.2d 299, 306, 96 P.3d 957 (2004). "The collateral estoppel doctrine

¹ Section 12(2) of the Securities Act of 1933¹, codified under 15 U.S.C. § 77i closely mirrors RCW 21.20.430(1).

promotes judicial economy and serves to prevent inconvenience or harassment of parties.” *Id.* at 307.

For collateral estoppel to apply, the party seeking application of the doctrine must establish that (1) the issue decided in the earlier proceeding was identical to the issue presented in the later proceeding, (2) the earlier proceeding ended in a judgment on the merits, (3) the party against whom collateral estoppel is asserted was a party to, or in privity with a party to, the earlier proceeding, and (4) application of collateral estoppel does not work an injustice on the party against whom it is applied.

Id.

RCW 21.20.430(1) only allows a buyer to “sue at law or in equity... upon the tender of the security.” RCW 21.20.430(6) provides any “tender specified in this section [RCW 21.20.430(6)] may be made at any time before entry of judgment.” *See also Windswept Corp. v. Fisher*, 683 F. Supp. 233, 239 (W.D. Wash. 1988) (dismissing plaintiffs’ claim because “plaintiffs chose to retain the stock and seek damages”).

Tendering the securities is a statutory condition precedent to obtaining judgment under the WSSA. Because Newcomer received judgment in his favor in the Securities Case, Newcomer necessarily tendered his shares, and collateral estoppel bars Cohen’s arguments to the contrary.

3. Even if Newcomer didn't own the securities at the time of the tender, courts still apply a recessionary measure of damages.

Even if Newcomer did not own his Apex interest at the time of trial, the judgment in the Securities Case reflects a recessionary measure of damages. This recessionary measure of damages unwound the offending transaction and restored Newcomer to his pre-contract state.

In *Randall v. Loftsgaarden*, 478 U.S. 647, 655, 106 S. Ct. 3143, 3149, 92 L. Ed. 2d 525 (1986), the United States Supreme Court explained the Securities Act applies “a rescissory¹ measure of damages” whether or not the investor owns the security at the time of judgment.

Thus, [15 U.S.C. § 771] prescribes the remedy of rescission except where the plaintiff no longer owns the security. Even in the latter situation, we may assume that a rescissory measure of damages will be employed; the plaintiff is entitled to a return of the consideration paid, reduced by the amount realized when he sold the security and by any “income received” on the security.

Randall, 478 U.S. at 655-56 (quoting 15 U.S.C. § 771(a)) (emphasis added; citations omitted). The court explained that the goal of the

¹ As secondary sources have noted, “Rescissory damages’ has been spelled numerous ways over the years [including] rescissionary, recissory, or recessionary damages. The same holds true for ‘rescission,’ which has been spelled recision and recission.” The different spellings have the same meaning. Elizabeth Chamblee Burch, *Reassessing Damages in Securities Fraud Class Actions*, 66 Md. L. Rev. 348, 373 (2007). Unless quoting to a source, Newcomer uses the spelling employed by the trial court and this Court in the Securities Case.

recessionary measure of damages is “a restoration of the plaintiff to his position prior to the fraud.” *Id.*

The goal of returning a plaintiff like Newcomer to the position prior to the fraud can only be accomplished if the LLC Agreement is rescinded and Cohen cannot compel additional capital contributions from Newcomer.

D. The trial court found the Apex LLC Agreements void as to Newcomer only.

Cohen and Apex make a strawman argument that the trial court’s decision impacts the rights of third parties. To the contrary, the clear language of the trial court’s decision voids the Apex LLC Agreements as to Newcomer only. The decision provides:

Once the original Apex Apartment, LLC was deemed void as to Mr. Newcomer, subsequent transfers involving the Apex Apartments, LLC property were necessarily void as well. That is because Mr. Newcomer divested ownership in the Apex Apartments, LLC at the time of filing the securities action, and because voiding the Apex Apartments, LLC agreement is necessary to restore Plaintiff Newcomer to the position he would have occupied had no contract occurred[.]

It is the Court’s determination that all transfers subsequent to the original of Apex Apartments, LLC are void as a consequence of the securities action findings, as that is the finding necessary to return Plaintiff to the position he would be in had no contract occurred.

CP 2598 (emphasis added).

The order makes no reference to any third party or any rights contemplated therein, and it clearly applies to Newcomer only. This order is consistent with the briefing that was in front of the court and relief requested.

Newcomer's supplemental briefing argued that as a result of the WSSA violation, "Cohen and Apex cannot enforce the rescinded LLC Agreements against Newcomer." CP 2348. In reply, Newcomer further argued, "Cohen cannot enforce the LLC Agreements against Newcomer" and "Newcomer cannot be compelled to make additional capital contributions to the Apex Entities." CP 2532, CP 2535.

In addition, "[a] judgment binds only those who are parties to the action in which it is rendered or those who are in privity with such parties, and it does not affect those who are strangers to it." *La Fray v. City of Seattle*, 12 Wn.2d 583, 588, 123 P.2d 345 (1942).

The parties did not argue and the court did not find that the order impacted third parties. Cohen's argument regarding the impact on "innocent parties" (Cohen Br. at 37) should not be considered by this Court on appeal.

E. Newcomer did not waive his right to assert RCW 21.20.430(5).

Cohen and Apex mistakenly argue Newcomer waived his right to assert RCW 21.20.430(5) by failing to assert it as an affirmative defense in

his answer to the Apex counterclaim. This argument fails for three reasons: (1) the parties briefed and argued RCW 21.20.430(5) before the trial court; (2) RCW 21.20.430(5) provides parties may not waive WSSA's protections; and (3) Cohen and Apex invited the error by moving to stay proceedings and conduct this appeal while Newcomer's motion to amend remains pending.

1. The parties briefed and argued the application of RCW 21.20.430(5).

Washington adopts a notice pleading standard to “facilitate a proper decision on the merits.” *CalPortland Co. v. LevelOne Concrete LLC*, 180 Wn. App. 379, 394, 321 P.3d 1261 (2014). “Generally, affirmative defenses are waived unless they are (1) affirmatively pleaded, (2) asserted in a motion under CR 12(b), or (3) tried by the express or implied consent of the parties.” *Bickford v. City Of Seattle*, 104 Wn. App. 809, 813, 17 P.3d 1240 (2001). “However, the rule’s policy is to avoid surprise and affirmative pleading is not always required.” *Id.*

“In determining whether the parties impliedly tried an issue, an appellate court will consider the record as a whole, including whether the issue was mentioned before the trial and in opening arguments, the evidence on the issue admitted at the trial, and the legal and factual

support for the trial court's conclusions regarding the issue.” *Dewey v. Tacoma Sch. Dist. No. 10*, 95 Wn. App. 18, 26, 974 P.2d 847 (1999).

Below, the parties specifically argued RCW 21.20.430's application to the facts of this case.

Moreover, Cohen misplaces his reliance upon *Harting v. Barton*, 101 Wn. App. 954, 962, 6 P.3d 91 (2000) in support of his waiver argument. There, the tenant raised affirmative defenses for the first time on appeal following a bench trial. *Id.* at 960-61.

Here, Newcomer raised RCW 21.20.430(5) in motions practice in front of the trial court well before trial or appeal. Newcomer timely asserted RCW 21.20.430(5) below.

2. By statute, Newcomer cannot waive RCW 21.20.430(5).

Cohen's waiver argument also conflicts with the plain language of RCW 21.20.430(5). In relevant part, RCW 21.20.430(5) reads: “Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.” Thus, Newcomer cannot waive the defense of RCW 21.20.430(5), particularly where the parties briefed and argued the matter before the trial court.

3. Cohen moved to stay proceedings while Newcomer's motion to amend his answer to the counterclaim remains outstanding.

Finally, Cohen invited the error upon which he now complains. "The invited error doctrine prohibits a party from setting up an error at trial and then complaining of it on appeal." *Angelo Prop. Co., LP v. Hafiz*, 167 Wn. App. 789, 823, 274 P.3d 1075 (2012) (quotes and alterations removed).

On February 10, 2017, Newcomer sought leave to amend his answer to Apex TIC and Apex Condos' counterclaim to assert an affirmative defense of RCW 21.20.430(5). CP 3122-3136. The motion was noted for February 24, 2017. CP 3120-3121. On February 14, 2017 the trial court issued its order on partial summary judgment finding that RCW 21.20.430(5) prevents Cohen from enforcing the Apex LLC Agreements against Newcomer. CP 2595-2599.

However, on February 17, 2017, prior to Newcomer's hearing on his motion to amend, Cohen moved, on a shortened schedule, to stay proceedings pursuant to CR 54(b). CP 3137-3176. The trial court granted Cohen's motion to stay prior to any hearing on Newcomer's still-pending motion to amend. Therefore, Cohen cannot now complain Newcomer failed to amend his answer to assert the affirmative defense.

F. Even if this Court rejects RCW 21.20.430(5), the Apex LLC Agreements are still voidable by Newcomer as a result of Cohen's fraud.

In addition to the clear statutory mandate of RCW 21.20.430(5), the jury's finding in the Securities Case that Cohen "made a material misrepresentation or omission reasonably relied on by Newcomer" by itself renders the contract voidable by Newcomer. CP 1098.

Washington follows the Restatement (Second) of Contracts. Section 164(1) provides: "If a party's manifestation of assent is induced by either a fraudulent or a material misrepresentation by the other party upon which the recipient is justified in relying, the contract is voidable by the recipient." *Yakima Cty. (W. Valley) Fire Prot. Dist. No. 12 v. City of Yakima*, 122 Wn.2d 371, 390, 858 P.2d 245 (1993). "[A] claim that entry into a contract was induced by fraud makes the contract voidable." *Pinkis v. Network Cinema Corp.*, 9 Wn. App. 337, 340, 512 P.2d 751 (1973). "Even a material innocent misrepresentation can render a contract voidable." *Yakima Cty. (W. Valley) Fire Prot. Dist. No. 12*, 122 Wn.2d at 390.

Where a court voids a contract pursuant to a party's misrepresentation, the court will subsequently apply the remedy of rescission. *Bloor v. Fritz*, 143 Wn. App. 718, 740, 180 P.3d 805 (2008)

(applying remedy of rescission where broker misrepresented prior drug activity to purchasers of home).

An LLC Agreement is a contract between the members and the LLC itself. RCW 25.15.006(7) (defining limited liability company agreement). Because Newcomer prevailed in the Securities Case, Newcomer necessarily proved the elements of security fraud: “(1) a fraudulent or deceitful act committed (2) in connection with the offer, sale or purchase of any security.” *Kinney v. Cook*, 159 Wn.2d 837, 842, 154 P.3d 206 (2007) (emphasis added). This fraud renders the LLC Agreements, entered into on the basis of Cohen’s fraud or misrepresentation, voidable by Newcomer, a remedy he elected. As reflected by *Bloor*, Newcomer’s decision to void the LLC Agreement results in rescission. Clearly, whether under general contract law or WSSA, the remedy of rescission applies. This rescission extricates Newcomer and his entities from Apex. Apex cannot enforce the rescinded LLC Agreements against Newcomer.

G. The trial court properly requested additional briefing on a briefing schedule that allowed the parties to respond.

Cohen and Apex imply that they did not have sufficient time to respond to the trial court’s request for additional briefing.

The trial court's scheduling of motions is reviewed on an abuse of discretion standard. *Bldg. Indus. Ass'n of Washington v. McCarthy*, 152 Wn. App. 720, 743, 218 P.3d 196 (2009); *Winston v. State/Dep't of Corr.*, 130 Wn. App. 61, 65, 121 P.3d 1201 (2005); *see also* CR 56(f) ("court may refuse the application for judgment or may order a continuance... or may make such other order as is just"). "A trial court abuses its discretion if it bases its decision on untenable or unreasonable grounds." *Bldg. Indus. Ass'n of Washington*, 152 Wn. App. at 743.

Likewise, "[e]very court of justice has power... [t]o provide for the orderly conduct of proceedings before it." RCW 2.28.010. A trial court may exercise discretion to control access and briefing before it. *See In re Marriage of Giordano*, 57 Wn. App. 74, 78, 787 P.2d 51 (1990) (reviewing trial court's moratorium on motions under abuse of discretion standard).

Below, Newcomer and Apex filed motions for partial summary judgment on November 18 and November 23, respectively. The parties undisputedly complied with CR 56(c)'s briefing schedule. The trial court heard argument on the respective motions for partial summary judgment on December 23, 2016, January 6, 2017, and January 9, 2017. At the January 9, 2017 hearing, the trial court called for additional briefing and

discussed a briefing schedule with counsel. The court set a hearing on the supplemental briefing for January 27, 2017.

Cohen and Apex offer no authority that a trial court cannot request briefing and set a corresponding briefing schedule for supplemental briefing. To the contrary, a court may request additional briefing to properly decide a case. *See, e.g.*, RCW 2.28.150 (“if the course of proceeding is not specifically pointed out by statute, any suitable process or mode of proceeding may be adopted which may appear most conformable to the spirit of the laws”); CR 1 (civil rules “shall be construed and administered to secure the just, speedy, and inexpensive determination of every action”).

Thus, to the extent required, the trial court could (1) request additional briefing and (2) set a briefing schedule which expressly provided Cohen an opportunity to respond. In no event should this Court reverse the trial court regarding the timing of the trial court’s briefing schedule.

H. In the alternative, this Court may affirm the trial court based upon on the unambiguous language of the LLC Agreements which makes further contribution permissive but not mandatory, relieving Newcomer of any further capital call obligation.

In addition to the restriction on enforcing a capital call imposed by RCW 21.20.430(5), the plain language of the Apex LLC Agreements

prevent Cohen from compelling a member to make a capital contribution. Therefore, a capital call cannot be used to offset the underlying Promissory Note obligations.

The unambiguous language of the LLC Agreements expressly defines the Apex Entities' remedy in the event a member refuses a capital call. Section 8.2.3 of the LLC Agreements, the documents read:

In the further event that a member is unable, unwilling, or for whatever reason fails to pay such capital call ..., then the following shall occur: the remaining Members shall have the right, but not the obligation, to buy on a pro-rata basis, all of the Units and interest in the Company held by the non-contributing Member. ... The purchase price shall be the value of the non-paying Member's Capital Account as recorded in the records of the Company, less the dollar amount of the non-paying Member's capital call which generated the default. The intent is to penalize the non-paying Member and to ameliorate the unanticipated additional cost to those Members who comply with this Agreement.

In the event that no member is willing to buy the interest of the non-paying Member, then the Company will be dissolved in accordance with the terms of Article 14.

CP 170 (emphasis added).

In addition, Article 14 expressly negates any requirement to make a further contribution upon dissolution:

14.4 No obligation to Restore Negative Capital Account Balance on Liquidation. Notwithstanding anything to the contrary in this Agreement, upon liquidation ... if any Unit Holder has a negative Capital Account balance ... such Unit Holder shall have no obligation to make any Capital

Contribution to the Company and the negative balance of such Unit Holder shall not be considered a debt owed by such Unit Holder to the Company or to any other Person for any Purpose whatsoever.

CP 179 (emphasis in original).

This Court “may affirm on any ground supported by the record.” *Hoover v. Warner*, 189 Wn. App. 509, 526, 358 P.3d 1174 (2015), *review denied*, 185 Wn.2d 1004, 366 P.3d 1243 (2016); *Gronquist v. State*, 177 Wn. App. 389, 396 n. 8, 313 P.3d 416 (2013).

As a matter of law, where parties to a contract identify a contractual remedy courts presume the parties intended such remedy as the sole remedy. In *United Glass Workers' Local No. 188 v. Seitz*, 65 Wn.2d 640, 642, 399 P.2d 74 (1965), our Supreme Court explained:

This court is committed to the view that, when parties to a contract foresee a condition which may develop and provide in their contract a remedy for the happening of that condition, the presumption is that the parties intended the prescribed remedy as the sole remedy for the condition.

(emphasis added); *see further Grant Cty. Port Dist. No. 9 v. Washington Tire Corp.*, 187 Wn. App. 222, 235, 349 P.3d 889 (2015) (quoting and affirming *United Glass Workers* cited above).

Therefore, if a capital call is made and a member does not want to comply, the only consequence to the non-contributing member is (1) loss of membership interest or (2) dissolution of Apex. Apex cannot sue the

non-contributing member for a money judgment. Newcomer understood these restrictions and, having tendered his interest in all Apex Entities, has no opposition dissolution. CP 1095, CP 2144.

Consequently, because no contractual right of further payment exists, Cohen and Apex cannot shield themselves from liability under the pretext of a capital call made to offset the Promissory Note liability.

I. Newcomer is entitled to an award of attorney's fees in this appeal.

Newcomer asks this Court to award attorney's fees and cost on appeal, pursuant to RAP 18.1 and the Promissory Note.

Paragraph 4 of the Promissory Note provides:

If any litigation or other proceeding is commenced by a party hereto to enforce or interpret any provision of this Note, or to collect any amount due hereunder, the prevailing party in such litigation or other proceeding shall be entitled to receive, in addition to all other sums and relief, its reasonable attorneys costs and attorney's fees incurred both at and in preparation for such trial or other proceeding and any appeal therefore or review thereof.

CP 8. Accordingly, this Court should award Newcomer fees and costs on appeal.

IV. CONCLUSION

For the above reasons, Newcomer respectfully requests this Court affirm the trial court's February 14, 2017 decision and February 24, 2017 order and award Newcomer's attorney's fees incurred on appeal.

Respectfully submitted this 13th day of October, 2017.

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