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

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REAL CARRIAGE DOOR COMPANY, INC., ex rel. SCOTT T. REES,  
MARDIE A. R. BRODERICK and JEREMY BRODERICK,  
Shareholders Thereof; and SCOTT T. REES, MARDIE A.R. BRODERICK  
and JEREMY E. BRODERICK, Individually

Appellants/Plaintiffs,

vs.

DON T. REES

Respondent/Defendant.

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**BRIEF OF RESPONDENT**

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## I. INTRODUCTION

The Respondent, Don Rees ("Don"), founded Real Carriage Door Company ("RCDC") and through his efforts made it a successful business. Don subsequently employed his children, the Appellants, Scott Rees, Mardie (Rees) Broderick and her husband Jeremy Broderick (collectively the "Appellants") at RCDC. During that time, the Appellants were gifted stock in RCDC and received annual stock dividends. After the Appellants voluntarily terminated their employment with RCDC, RCDC stopped issuing stock dividends. The Appellants subsequently commenced this action alleging Don breached his fiduciary duties to them and/or oppressed them by increasing his salary (despite not changing his total compensation), by receiving a loan from RCDC (that was approved by the shareholders and directors of RCDC), and by not issuing stock dividends to them after they voluntarily terminated their employment. Following a three day trial, the Honorable G. Helen Whitener dismissed all of the Appellants' claims and they now appeal. Judge Whitener's decision should be affirmed in all respects.

## II. RESTATEMENT OF ISSUES

1. Are the trial court's findings of fact to which the Appellants assign error supported by substantial evidence in the record (Findings of Fact Nos. 5-8, 11, 12, 15-20)?

2. Do the findings of fact support the trial court's conclusions of law dismissing the Appellants' claims with prejudice (Conclusions of Law 3-16)?

3. Are the Appellants entitled to the judgment they seek on their claims as a matter of law based on their version of disputed facts, which were rejected by the trial court sitting as a finder of fact?

## III. RESTATEMENT OF THE CASE<sup>1</sup>

Respondent Don Rees has been a licensed home builder in Washington State for over thirty years. Verbatim Report of Proceedings ("VRP") 6/18/19 at 129:06-130:19; CP 262 (***Finding of Fact No. 1***). Don incorporated and is the founder of Real Carriage Door Company, Inc. ("RCDC"), which he grew from his construction and business experience. VRP 6/18/19 at 130:20-131:1. RCDC designs and manufactures interior and exterior swing-out and sliding carriage doors and barn doors, and the hardware that makes them

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<sup>1</sup> The Appellants make numerous statements in their Statement of the Case without citation to the record or which constitute argument and should be disregarded by the Court. RAP 10.3(a)(5); *State v. Camarillo*, 54 Wn. App. 821, 829, 776 P.2d 176 (1989).

swing and slide, which it sells throughout the nation. Ex. 1 at ¶¶4. Appellants are two of Don's children, Scott Rees and Mardie Broderick, and the remaining appellant is Mardie's husband, Jeremy Broderick, each of whom were gifted stock in RCDC. Ex. 1 at ¶¶1.

**A. RCDC's Origin.**

Before Don started RCDC, he spent over two decades building single-family homes as a "renaissance builder" – Don performed all the aspects of a project himself, including designing, budgeting, permitting, and the construction work itself. VRP 6/18/19 at 129:19-130:19. There were some lean years, and Don did whatever work and projects he could as the sole provider for his family. VRP 6/18/19 at 130:17-19, 137:13-14.

In 1995, Don took some time away from his contracting work to design and build a home for his family. VRP 6/18/19 at 131:24-132:9. It was during that project that he first developed the idea of incorporating old-style, swing-out carriage doors in a new home or remodel design. Don designed and built a set of carriage doors himself, modified an ordinary overhead garage door opener to make them swing automatically, and installed them in the house. VRP 6/18/19 at 132:10-21.

When the home was complete, Don and his family took a "hiatus" and moved to Ecuador where Don worked as a carpenter for three years. VRP 6/18/19 at 132:22-135:22. When they returned in

1998, Don was “quite broke.” VRP 6/18/19 at 135:23-25. Although difficult, Don resumed his construction work as best he could. VRP 6/18/19 at 137:10-17.

In 2000, Don designed and built a home for a customer that incorporated the automatic-opening, swing-out carriage doors that he had previously designed, manufactured and installed in his own home. The doors were an immediate success. VRP 6/18/19 at 137:18-138:8. Don then decided to include his new innovation on his “Rees Builders” website and he subsequently began receiving requests for his products from all across the country. VRP 6/18/19 at 138:9-140:7. Although orders for Don’s doors began pouring in, Don continued to work alone, building the doors himself in his garage during his spare time while continuing with his home building business. VRP 6/18/19 at 140:8-142:13.

In 2004, Don formed Real Carriage Door Company LLC as the business vehicle to focus exclusively on his door design and manufacturing business. VRP 6/18/19 at 143:4-8; Ex. 1 at ¶4. In 2005, Don converted the company from a limited liability company to a corporation, Real Carriage Door Company, Inc., and elected to have the corporation treated as a subchapter “S” corporation under the internal revenue code. VRP 6/18/19 at 143:4-8; Ex. 1 at ¶4; CP 262 (*Findings of Fact Nos. 2 and 3*). By 2005, RCDC had

completed approximately 150 sets of doors and Don decided to focus his efforts on RCDC full-time. VRP 6/18/19 at 143:10-12.

RCDC quickly gained national recognition in the garage door industry. VRP 6/18/19 at 146:6-147:19. Don continued to innovate in product quality and design, and further broadened RCDC's product line. Most notably, he decided to create "sliding" doors and innovated new designs and configurations for the hardware to make them slide. VRP 6/18/19 at 152:8-153:19; Ex. 1 at ¶4. RCDC's sliding doors were very popular and that success has continued into what is now nationally known as "barn door hardware." VRP 6/18/19 at 155:12-156:10; 158:5-159:16; Ex. 1 at ¶4. As a result, competitors have been trying to emulate RCDC and its products, in some instances even copying its products, requiring Don to continue innovating new and different products so RCDC may remain competitive. VRP 6/18/19 at 161:8-163:6; Ex. 1 at ¶4.

Put succinctly, RCDC does not and could not exist without Don's ability to continuously create, innovate and bring to market new products. VRP 6/18/19 at 166:14-18.

**B. RCDC's Success Allows Don To Bring The Appellants Into The Business.**

RCDC's rapid growth allowed Don to make RCDC a family affair. In 2005, Appellant Mardie Rees was unemployed, so Don hired her to answer phones and put proposals together to provide

income to her and time for him to focus on advancing the business. VRP 6/18/19 at 143:19-143:5. She later worked in sales. Ex. 1 at ¶5; CP 262 (***Finding of Fact No. 7***).

In 2006, Don's then-wife, Beth Rees ("Beth"), filled in for Mardie to give Mardie time off and time to travel. VRP 6/18/19 at 145:15-20. Beth continued to be employed at RCDC and subsequently gravitated towards human resources responsibilities. Ex. 1 at ¶5.

In 2006, Don created a position for his son, Appellant Scott Rees, who had recently graduated from college, was unemployed and needed a job. VRP 6/18/19 at 144:22-145:14. Scott eventually managed the company website and growing IT needs. Ex. 1 at ¶5; CP 262 (***Finding of Fact No. 6***). Don also hired Mardie's husband, Appellant Jeremy Broderick, after he relocated to Washington, and he worked as a door drafter, later moving into pricing and sales. VRP 6/18/19 at 158:5-6; Ex. 1 at ¶5; CP 262 (***Finding of Fact No. 8***).

By 2008, Don was employing all of the Appellants, his then wife Beth, a bookkeeper, and five carpenters and RCDC was generating an annual gross income of approximately \$1.9 million. Ex. 1 at ¶6.

**C. Don And Beth's Estate Planning – Gifting Shares To The Appellants.**

In 2010, Don and Beth began developing a plan, in consultation with their accountant, to begin gifting some of their shares in RCDC to the Appellants. VRP 6/19/19 at 7:1-7; 10:16-11:6; Ex. 1 at ¶7; Ex. 101. The plan had several goals: First, as a part of their long-term estate planning, each year Don and Beth could gift to the Appellants RCDC stock valued at or near the annual estate tax exemption threshold and thus avoid taxes. VRP 6/19/19 at 7:8-10:12; Ex. 1 at ¶7; Ex. 101. Second, once the shares were gifted to the Appellants, Don and Beth could make stock dividend distributions to the Appellants as additional compensation and to incentivize them to make meaningful contributions to RCDC's success. VRP 6/19/19 at 7:8-10:12; Ex. 1 at ¶7. Finally, by gifting the shares over time, it would make it more affordable for Appellants to someday purchase the remaining RCDC shares from Don and Beth when they decided to step away from the business and retire. *Id.* The notion was to groom the Appellants to eventually "take the company reins" and preserve RCDC as a Rees family legacy. *Id.*

A critical component of the gifting "plan" was the Appellants' commitment to remaining RCDC employees and making ongoing

contributions to the success of the company. VRP 6/19/19 at 9:5-7; 9:25-10:12. The Appellants assured Don that they were indeed committed to making RCDC successful, stating “Yes, we’re in”, and with the Appellants’ assurances Don and Beth moved forward with the plan. VRP 6/17/19 at 39:18-40:24; VRP 6/19/19 at 9:23-24; 10:13-15. For each year beginning in 2010 and until 2013, Don and Beth gifted shares of RCDC stock to the Appellants valued at or near the maximum amount allowed under the applicable annual estate tax exemption limits. VRP 6/19/19 at 10:16-11:9; Ex. 1 at ¶¶ 8; Ex. 101; CP 262 (***Findings of Fact Nos. 6, 7 and 8***).

The Appellants paid nothing in exchange for their RCDC shares. VRP 6/17/19 at 30:9-17; 39:19-22; 52:10-12; Ex. 127; CP 262 (***Findings of Fact Nos. 6, 7 and 8***). With the exception of Appellant Mardie Broderick (who left RCDC in 2009 after the birth of her first daughter<sup>2</sup>), their general responsibilities as RCDC employees remained unchanged. Ex. 1 at ¶¶8. By January 2013, the percentage ownership of the outstanding RCDC stock was as follows:

Don Rees – 51%  
Beth Rees – 37%

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<sup>2</sup> Ms. Broderick subsequently provided occasional consulting services to RCDC on an independent contractor basis but that stopped before 2015. VRP 6/17/19 at 51:14-20; Ex. 1 at ¶¶8 fn. 1.

Scott Rees – 6%  
Mardie Broderick – 3.1%  
Jeremy Broderick – 2.9%.

Ex. 1 at ¶8; CP 262 (***Findings of Fact Nos. 6, 7, and 8***).

**D. Don And Beth's Separation And Eventual Divorce.**

In 2013, Don and Beth's marriage began to unravel and the gifting plan stopped. VRP 6/19/19 at 11:10-13; Ex. 1 at ¶9. They separated in March 2013, and tensions between the family members began immediately. VRP 6/19/19 at 12:7-13:2; Ex. 1 at ¶9; CP 262 (***Finding of Fact No. 9***). The Appellants became angry, blamed Don for the separation and sided with Beth. VRP 6/19/19 at 12:7-19; Ex. 1 at ¶9.

The Appellants expressed their displeasure to Don by becoming cold and insubordinate and refusing to communicate with him, even on matters concerning RCDC. VRP 6/19/19 at 12:11-19; 14:11-23; 15:22-16:22; Ex. 1 at ¶¶10-14. The Appellants' witness and RCDC's bookkeeper from 2011-15, Jennifer Pomeroy, testified that the Appellants were "impolite" and "not friendly" to Don, and "difficult to work with." VRP 6/17/19 at 67:16-19; 86:13-87:4. She observed that the Appellants avoided Don, and that they would not "work with him or compromise with him." VRP 6/17/19 at 87:6-9. She also confirmed that the Appellants subsequently stopped communicating with Don

entirely<sup>3</sup>, and that they refused to talk with him and try to “figure things out together.” VRP 6/17/19 at 87:6-9. Ms. Pomeroy acknowledged that the Appellants were making business decisions affecting RCDC without consulting with Don, even though the decisions required Don’s approval as RCDC’s President and CEO. VRP 6/17/19 at 87:25-88:21; VRP 6/19/19 at 23:19-24:8.

More than a year after their separation, in April 2014, Don filed for divorce. VRP 6/19/19 at 12:20-13:2; Ex. 1 at ¶14; CP 262 (***Finding of Fact No. 9***). Not long afterwards, in November and December 2014, Appellants Scott Rees and Jeremy Broderick abruptly terminated their employment with RCDC.<sup>4</sup> VRP 6/19/19 at 30:9-31:10; 32:12-33:6; Ex. 1 at ¶15; CP 262 (***Findings of Fact Nos. 6, 8 and 12***). At the same time and in a coordinated effort, Beth attempted to wrestle control of RCDC from Don by demanding the Court in their dissolution action issue a restraining order preventing Don from making any decisions regarding RCDC matters without her participation. VRP 6/19/19 at 31:19-33:6; Ex. 1 at ¶15. The Court

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<sup>3</sup> The Appellants attempted to increase the pressure on Don by recruiting their sister, Kim Smith, into rejecting Don. VRP 6/18/19 at 122:18-123:25. When Kim refused to engage in that behavior, the Appellants also stopped communicating with her. VRP 6/18/19 at 124:1-125:10.

<sup>4</sup> Appellants Scott Rees and Jeremy Broderick have had no further involvement with RCDC since they voluntarily terminated their employment in 2014. VRP 6/17/19 at 40:2-10; Ex. 1 at ¶25; CP 262 (***Findings of Fact Nos. 6, 7, 8 and 12***).

denied Beth's motion and immediately thereafter she agreed to a settlement and resolution of the divorce proceedings by transferring her RCDC stock to Don. VRP 6/19/19 at 33:7-11; Ex. 1 at ¶16; Exs. 102 and 103; CP 262 (***Finding of Fact No. 9***).

**E. Don And Beth Settle Their Divorce - Don Agrees To Buy Beth's RCDC Shares.**

In the divorce settlement, Beth agreed to transfer her stock to Don in exchange for an approximately \$3,000,000.00 cash payment. VRP 6/19/19 at 34:2-20; Ex. 1 at ¶16; Exs. 102 and 103; CP 263 (***Finding of Fact No. 10***). It was understood that Don did not have the cash to make such a payment and would borrow the funds from RCDC. VRP 6/19/19 at 35:20-23; Ex. 1 at ¶17. Accordingly, the funds paid to Beth were obtained through a combination of an assignment of a RCDC brokerage account, existing cash reserves and the proceeds from a loan RCDC obtained from Timberland Bank. VRP 6/19/19 at 34:3-8; 35:13-39:4; Ex. 1 at ¶18; Exs. 8, 114-116; CP 263 (***Finding of Fact No. 11***).

The funds Don borrowed from RCDC and paid to Beth were always considered a loan to Don that he would pay back to RCDC. VRP 6/19/19 at 35:24-36:1; 41:15-19; Ex. 1 at ¶17; CP 263 (***Finding of Fact No. 16***). At the time the payments to Beth were made, Don

met with Ms. Pomeroy, RCDC's bookkeeper, and with RCDC's accountant, and specifically directed Ms. Pomeroy to treat the funds as a loan, which Ms. Pomeroy confirmed in her testimony. VRP 6/17/19 at 91:16-21; 96:16-97:7. Ms. Pomeroy also memorialized in her notes that she was to treat the funds as a loan to Don. VRP 6/17/19 at 89:25-91:15; Ex. 121. For some unexplained reason, Ms. Pomeroy incorrectly booked some funds as an "owner dividend"<sup>5</sup> and failed to book the brokerage account transfer to Beth at all. VRP 6/19/19 at 50:21-51:1-8. In early 2016 when Don began assembling the information for RCDC's 2015 tax return, he discovered these bookkeeping mistakes and immediately directed RCDC's new bookkeeper to make appropriate corrections, which she did. VRP 7/18/19 at 72:20-73:3; VRP 6/19/19 at 51:2-19.

As a result of the chaos intentionally created by the Appellants, the increased workload he was carrying at RCDC by having to perform the Appellants' and Beth's jobs as well as his own, and the stress of finalizing his divorce from Beth, Don inadvertently did not sign a promissory note in 2015 memorializing the loan. VRP 6/19/19 at 41:15-42:15. In 2016 when this oversight came to Don's

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<sup>5</sup> Ms. Pomeroy booked \$1,000,000.00 of the funds as "Owner Equity: Owner-Draws – Beth." Ex. 12.

attention, he sent a notice to the Appellants scheduling a special shareholders meeting for the express purpose of approving the loan. VRP 6/19/19 at 46:20-47:16; Ex. 110; CP 263 (***Finding of Fact No. 15***). The Appellants received the notice, knew precisely what was to be discussed and chose not to attend the meeting. VRP 6/17/19 at 40:21-41:11; 42:2-19; 59:23-60:8; VRP 6/19/19 at 47:19-48:2; Exs. 111 and 127; CP 263 (***Finding of Fact No. 15***).

The RCDC shareholder meeting was held on October 14, 2016, the loan was approved by the shareholders, and Don executed the note obligating himself to pay the money back to RCDC, with interest and with an effective date of December 31, 2015 (hereinafter referred to as the "2015 Loan")<sup>6</sup>. VRP 6/18/19 at 121:18-23; 6/19/19 at 48:3-16; Exs. 112 and 113; CP 263 (***Finding of Fact No. 16***). RCDC's Directors and Officers, most of whom owned no shares in RCDC, also approved the 2015 Loan. VRP 6/18/19 at 121:18-23; Ex. 1 at ¶¶19 and 22; CP 263 (***Findings of Fact Nos. 13 and 14***).

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<sup>6</sup> The principal amount of the note is \$3,189,582, which, in addition to the cash amounts paid to Beth, also includes miscellaneous smaller payments that RCDC had made to Beth, or for her benefit, that Don agreed to personally assume. This also included \$150,000 in cash that Beth unilaterally and without Don's knowledge withdrew from RCDC's accounts. VRP at 6/19/19 at 42:24-42:15; Ex. 1 at ¶ 20, fn. 3.

The Appellants acknowledged at trial that at no time prior to the October 2016 shareholders' meeting did they understand the funds paid to Beth was a dividend distribution and not a loan to Don, and Don never concealed the 2015 Loan from the Appellants. VRP 6/17/19 at 42:23-43:17; 59:23-61:8; VRP 6/18/19 at 41:4-16; 121:18-122:11; VRP 6/19/19 at 42:16-17; 51:20-23. Don has subsequently made all the payments to RCDC due under the promissory note.<sup>7</sup> VRP 6/19/19 at 43:16-18.

F. **RCDC Stops Dividend Distributions And Increases Don's Salary.**

Prior to 2015, Don and Beth paid themselves smaller salaries than the revenue from RCDC certainly justified, never receiving more than \$190,000 per year as salary between them. Ex. 1 at ¶23; CP 263 (***Findings of Fact Nos. 17 and 18***). Instead, most of the compensation they received was through annual stock dividend distributions because stock dividends are taxed at a much lower rate than wages or salary, resulting in a significant tax savings to them. Ex. 1 at ¶23; CP 263 (***Finding of Fact No. 18***). As RCDC's profits

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<sup>7</sup> Although Don inadvertently missed the first annual payment due under the note, he corrected that oversight and has made all other payments that have come due under the note. VRP 6/18/19 at 60:4-61:16; 65:3-11; 66:4-14; VRP 6/19/19 at 43:19-44:11; Ex. 126; CP 263 (***Finding of Fact No. 16***).

increased, so did the dividend distributions. Ex. 1 at ¶23; Exs. 122-126; CP 264 (***Finding of Fact No. 19***).

As described above, Don and Beth gifted RCDC shares to the Appellants as part of a plan to incentivize the Appellants to stay with RCDC, contribute to its success and eventually “take the company reins” to preserve the Rees legacy. Accordingly, as Don and Beth received a salary and dividend distributions for their total compensation, the Appellants also received a salary and their *pro rata* dividend distributions for their total compensation. Ex. 1 at ¶24; CP 264 (***Finding of Fact No. 19***).

After the Appellants abruptly terminated their employment with RCDC and no longer contributed to its success, it made no sense to continue compensating the Appellants with either a salary or stock dividends. VRP 6/19/19 at 51:24-52:9; 52:10-18; Ex. 1 at ¶25. Accordingly, RCDC ceased distributing stock dividends in 2015 and increased Don’s salary so that his total compensation would remain the same. VRP 6/19/19 at 51:24-52:1; 52:3-20; 68:3-18; CP 264 (***Finding of Fact No. 20***).

The total compensation RCDC paid to Don in 2015 (\$1,213,618) was almost exactly the same as RCDC paid to Don and Beth in salary and dividends in 2014 (\$1,306,257), even though

RCDC's gross profit had increased from \$3,505,499 (2014) to \$3,955,518 (2015). VRP 6/19/19 at 52:25-53:3; Exs. 123, 124 and 129; CP 263 (***Finding of Fact No. 17***). In other words, there was no material net change in total shareholder-employee compensation from 2014 to 2015. Despite Don's additional duties, Don's total annual compensation since 2015 has remained the same or less than all previous years, either as a total dollar amount or as a percentage of RCDC's gross profit. VRP 6/19/19 at 53:10-14; Ex. 1 at ¶28; Exs. 122-126, 129; CP 263-64 (***Findings of Fact Nos. 17 and 20***). It is only the characterization of the form of compensation that Don has received since 2015 (salary plus dividends vs. salary only) that has changed.

The Appellants testified at trial that they had no objection to the total compensation RCDC paid to Don and Beth prior to 2015. VRP 6/17/19 at 45:9-22; 62:9-14. Only now, after the Appellants have discovered their voluntary termination of employment from RCDC would result in no further gifts of stock or dividends, do they decide the ratio of salary to stock dividend constituting Don's total compensation must not change, even though Don is now performing all of the work and they do nothing.

Since 2015, Don has had to perform his job and all that entails, and also the jobs previously performed by Beth and Appellants before they abandoned RCDC. VRP 6/18/19 at 40:9-24; 6/19/19 at 53:5-9; Ex. 1 at ¶27; CP 264 (***Finding of Fact No. 20***). The Appellants left Don to run RCDC alone, with the apparent intent that he would flounder and could then be removed from the company. As it turned out, without the Appellants involved in the business Don was able to run RCDC much more efficiently and effectively: in 2015, the year after the Appellants terminated their employment, RCDC enjoyed its best financial year ever. VRP 6/19/19 at 59:17-60:6; Exs. 122-124, 129. And yet, Don's total compensation in 2015, as the only remaining RCDC shareholder-employee, was less in terms of percentage of gross profit than it was in 2014 and has remained so ever since. VRP 6/19/19 at 53:10-14; 68:24-69:10; Exs. 125, 126, 129.

**G. Appellants' Commencement Of This Case.**

In March 2018, the Appellants commenced this case alleging (1) Breach of Fiduciary Duties; (2) Fraud; (3) Declaratory Judgment; (4) Injunctions, and (5) Minority Shareholder Oppression. CP 1-7. The matter went to trial for three days and the Honorable G. Helen Whitener found in favor of Don and dismissed all of the Appellants'

claims with prejudice. This Court should affirm Judge Whitener's decision in all respects.

#### IV. RESPONSE ARGUMENT

##### A. Standard of Review

In *McCleary v. State*, 173 Wn. 2d 477, 514, 269 P.3d 227 (2012), the Supreme Court expressed the standard of review following a bench trial as follows:

We review a trial court's challenged findings of fact for substantial evidence. *Sunnyside Valley Irrigation Dist. v. Dickie*, 149 Wash.2d 873, 879, 73 P.3d 369 (2003). Substantial evidence is "defined as a quantum of evidence sufficient to persuade a rational fair-minded person the premise is true." *Id.* (citing *Wenatchee Sportsmen Ass'n v. Chelan County*, 141 Wash.2d 169, 176, 4 P.3d 123 (2000)). We will not "disturb findings of fact supported by substantial evidence even if there is conflicting evidence."

The appellate court reviews the evidence in the light most favorable to the prevailing party and defers to the trial court regarding witness credibility and any conflicting testimony. *Pilcher v. State Dep't of Revenue*, 112 Wn. App. 428, 435, 49 P.3d 947 (2002). The party challenging a finding of fact bears the burden of demonstrating the finding is not supported by substantial evidence. *Mairs v. Dep't of Licensing*, 70 Wn. App. 541, 545, 854 P.2d 665, 668 (1993). It is incumbent upon the Appellants to present the Court with argument as to why specific findings of the trial court are not supported by the

evidence and to cite to the record to support that argument. *Matter of Estate of Lint*, 135 Wn.2d 518, 531–32, 957 P.2d 755 (1998). Failing to do so burdens the Court with “assuming an obligation to comb the record with a view toward constructing arguments for counsel as to what findings are to be assailed and why the evidence does not support these findings. This we will not and should not do.” *Lint*, 135 Wn.2d at 532.

In this case, the Appellants make no effort to apprise the Court of the facts supporting any of the challenged findings. Instead, the Appellants argue as though their facts are the only facts in this case and no other. To the extent the Appellants fail to explain the insufficiency of the findings to which they have assigned error, those assignments of error should be considered waived. *Lodis v. Corbis Holdings, Inc.*, 192 Wn. App. 30, 64, n. 17, 366 P.3d 1246 (2015).

**B. The Findings Of Fact Are Supported By Substantial, If Not Overwhelming, Evidence, and They Support the Conclusions of Law.**

Respondent Don Rees has provided in his Restatement of the Case citation to the record demonstrating there is substantial evidence supporting all of the trial court’s findings of fact. Consequently, the remaining issue is whether or not the findings support the conclusions of law. *Sac Downtown Ltd. P’ship v. Kahn*,

123 Wn.2d 197, 202, 867 P.2d 605 (1994). However, the Appellants fail to argue that the trial court's findings (if left undisturbed) do not support its conclusions of law. Instead, the Appellants simply replace all the trial court's findings with their own "facts," and then apply the law to those "facts" to reach their desired conclusions, in complete disregard for the governing standard of review. The Appellants fail to demonstrate that a single one of the trial court's conclusions is unsupported by its findings and, therefore, the analysis can stop there and the Court can affirm the trial court's decision. Nevertheless, Don addresses the Appellants' legal arguments below, none of which have merit.

**C. Don Did Not Receive An Unreasonable Salary.**

The Appellants argue that Don's salary beginning in 2015 is excessive<sup>8</sup> (even though his total compensation has remained materially the same from previous years) because (1) the IRS "might" conclude Don's salary is not "reasonable" and a portion of it is a "disguised stock dividend"; (2) Don's salary is greater than the "fair market value replacement salary" expressed by their expert; and (3)

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<sup>8</sup> The Appellants use of the term "excessive" salary presupposes the salary was "unreasonable." The Appellants must first demonstrate that Don's salary was unreasonable, which they failed to do, before any determination can be made if there is an amount considered "excessive."

Don's salary results in a lower value for the company as a whole.<sup>9</sup>

None of these arguments have merit.

1. The trial court correctly rejected the Appellants' arguments that Don breached his fiduciary duties because the IRS "may" conclude that Don's salary is not "reasonable" and that it must include a stock dividend to avoid violating the rules for an "S" corporation.

The Appellants exhaustively analyze Internal Revenue Code provisions applicable to subchapter "S" corporations and how the IRS may interpret and apply them with respect to Don's salary. All of this analysis and associated argument is not only speculative, but assumes that the IRS is looking for reasons to challenge a tax return so that it results in a refund to a taxpayer. The trial court correctly rejected those arguments.

The Appellants' argument is that when Don increased his salary in 2015 to approximate the total compensation RCDC historically paid him through a combination of salary and stock dividends, Don breached his fiduciary duty<sup>10</sup> to RCDC and to the Appellants because he has:

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<sup>9</sup> Appellants are only pursuing these contrived arguments because they hope to have some portion of Don's compensation characterized as a stock dividend so that RCDC must then pay a *pro rata* stock dividend to them.

<sup>10</sup> Don has never disputed that he has a fiduciary duty to RCDC's minority shareholders. Don also does not dispute that the test for determining breach of that duty or minority shareholder oppression is whether or not Don's conduct is "burdensome, harsh and wrongful conduct; a lack of probity and fair dealing in the affairs of the company to the prejudice of some of its members; or a visible

(a) created a “risk” that the IRS will audit RCDC;

(b) that through the hypothetical audit the IRS “may” conclude that even though Don’s total compensation has not materially changed, because it previously consisted of both salary and stock dividend and now only consists of a salary, some part of his current salary must really still be a stock dividend which Don is carefully disguising by paying the higher tax rates (on a salary compared to a dividend);

(c) that RCDC has not reported any other stock dividends, so RCDC must have two different classes of stock (otherwise a *pro rata* dividend to the Appellants was required);

(d) that as a subchapter “S” corporation, RCDC cannot have two classes of stock; therefore

(e) RCDC “may be jeopardizing” its “S” corporation status.

None of this wild speculation has happened, of course, and the Appellants make no attempt to explain how it will happen. There is simply no evidence in the record that RCDC has issued more than one class of stock nor that the IRS would follow the Appellants’

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departure from the standards of fair dealing, and a violation of fair play on which every shareholder who entrusts his money to a company is entitled to rely.” *Scott v. Trans-System, Inc.*, 148 Wn.2d 701, 711, 64 P.3d 1 (2003); see Appellants’ Brief at P. 46. However, none of the trial court’s findings of fact (all of which are supported by substantial evidence) support a conclusion that Don breached any duty he owed to the Appellants. The Appellants simply use their version of the “facts” (which were rejected by the trial court), and then apply the law to those “facts” to reach their own preferred conclusions.

contrived assumptions just so it could then pay a refund to a taxpayer. The notion that the trial court somehow committed reversible error by refusing to adopt as facts the Appellants' purely speculative series of events is meritless.

Included within the Appellants' argument above is the assumption that the IRS will determine in its hypothetical audit that some portion of Don's salary is excessive (and therefore must be a stock dividend), because, of course, if it instead determines Don's salary is reasonable the Appellants' argument fails entirely. The Appellants argue the IRS will apply a test it has used to allocate the income a shareholder-employee receives from the corporation between salary and stock dividends for tax purposes as articulated in *Elliotts, Inc. v. Commissioner*, 716 F.2d 1241 (9th Cir. 1983). Appellants' Brief at 29, 33. However, the purpose of that test is to determine the applicable tax rate on the shareholder-employee's income, because the tax rate on salary is different from the tax rate on stock dividends. The test has no relationship to whether or not Don breached any fiduciary duty to the Appellants.<sup>11</sup> Regardless,

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<sup>11</sup> Even "if" the IRS conducted its hypothetical audit, and "if" it determines some portion of Don's salary is excessive, that would not require RCDC to then pay dividends to the Appellants, because there is no law requiring a corporation to pay stock dividends to shareholders. *Elliotts*, 716 F.2d at 1244 (A court "will not presume a disguised dividend from the bare fact that a profitable corporation does not pay dividends" because a corporation is not obligated to pay dividends).

the Appellants failed to prove that Don's salary was unreasonable under the *Elliotts* test.

In *Elliotts*, the IRS challenged part of a shareholder-employee's salary alleging it was really a disguised stock dividend, and therefore not an appropriate deduction against applicable tax under IRC §162(a)(1) as a "reasonable allowance for salaries or other compensation for personal services rendered."<sup>12</sup> The Court recognized "[t]he mere existence of [a sole shareholder-employee] relationship, however, when coupled with an absence of dividend payments, does not necessarily lead to the conclusion that the amount of compensation is unreasonably high." *Elliotts*, 716 F.2d at 1245. Consequently, the Court identified five broad categories to be analyzed when deciding if a shareholder-employee's salary was "reasonable" and thus payment in excess of what is "reasonable" must be a stock dividend, with no single factor being decisive of the question. *Elliotts*, 716 F.2d at 1245. The following summarizes the relevant areas of inquiry:

- Role in the company. Considerations include "the position held by the employee, hours worked, duties performed, as

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<sup>12</sup> The significance being that at that time (1983) funds paid as salary was subjected to a lower tax than a dividend (the maximum tax rate on salary was 50% and the maximum tax rate for stock dividends was 70%) and the IRS was seeking to reclassify a portion of the shareholder-employee's income as a dividend to then impose the higher tax rate. *Elliotts*, 716 F.2d at 1243. Now, the opposite is true: a higher tax is paid on salary and lower tax on stock dividends. Ex. 16 at ¶5. As a result, the IRS would likely agree with Don's characterization of his compensation as salary instead of a dividend not just because it is a reasonable salary, but also because it results in more tax revenue.

well as the general importance of the employee to the success of the company. *Id.*

- Comparison of employee's salary with those paid by similar companies for similar services. *Id.* at 1246.
- Character and condition of the company. The focus under this category "may be on the company's size as indicated by its sales, net income, or capital value." *Id.* Also relevant are "the complexities of the business and general economic conditions." *Id.*
- Conflict of interest, concerned primarily where the employee is the company's sole or controlling shareholder. *Id.*
- Internal consistency in a company's treatment of payments to employees. *Id.* at 1247.

The Appellants make no attempt to show how the factors specified in *Elliotts* demonstrate some part of Don's compensation must be a stock dividend. Although not specifically offered as an attempt to fulfill the *Elliotts* factors, the Appellants point out that Don's compensation in the form of a salary in 2015 and thereafter is substantially greater than it was before 2015. That is undisputed, although Don's total annual compensation between 2015 and 2018 remained the same or less than all previous years either as a total dollar amount or as a percentage of gross profit. VRP 6/19/19 at 53:10-14; Ex. 1 at ¶28; Exs. 122-126, 129; CP 263 (***Finding of Fact No. 17***). Nevertheless, the trial court rejected the notion that Don's historical compensation in the form of salary alone demonstrates Don's current salary is unreasonable.

2. The Appellants' expert only opined on what a prospective purchaser would use for Don's salary in valuing RCDC.

The Appellants argue that their expert, Shelley Drury, opined that "a reasonable, fair market salary for [Don] would be \$200,000, commencing in 2015 and thereafter." Appellants' Brief at 34. Ms. Drury did not apply the relevant factors under *Elliotts*.<sup>13</sup> Instead, Ms. Drury's opinion was very narrow and only related the "fair market value replacement salary" for Don in the context of "business valuation purposes". VRP 6/17/19 at 113:18-24; Ex. 14 at p. 2-4. That is, what value will a prospective purchaser of RCDC apply to a shareholder-employee for the purpose of determining the value of the corporation. That value is irrelevant to whether or not Don's salary is reasonable. Don's expert, Robert Ryan, explained all of this at trial:

Q: Okay. Are you familiar with a concept called "fair-market-value replacement salary"?

A: Yes.

Q: And what is it?

A: It's a concept that when someone is looking to value a company for a potential sale, you will look at what is

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<sup>13</sup> Treas. Reg. § 1.162-7 provides that to be a deductible expense, compensation in the form of salary must be reasonable. To determine if the salary is reasonable under this section, the Court applies the factors in *Elliotts*. *Elliotts*, 716 F.2d at 1245. Appellants spend two pages disputing Mr. Ryan's testimony that § 1.162-7(b)(1) does not apply to "S" corporations. Appellants' Brief at 28-30, 37. Assuming § 1.162-7(b)(1) does apply to RCDC, which it doesn't, the Appellants never apply the factors in *Elliotts* to demonstrate Don's salary was unreasonable.

the owner receiving? And you may say, if we had to replace the owner with a --- just an arm's-length employee, non-owner employee, we would be able to find somebody and put them in there at that stage. But it – it really is only used in the case of sales because it really has no – no effect, and sometimes it's used in the case of – you know, for a husband/wife that had a divorce; what is the value of the company? They're going to look to see how -- how much is the company worth in -- in those situations to determine what is appropriate property distributions.

\* \* \*

Q: Okay. So in your opinion, is a fair-market-value replacement salary at all relevant to what a private, closely held company pays shareholder employees?

A: No. It has no -- it has no relationship whatsoever.

VRP 6/18/19 at 56:14 - 57:4; 76:18-21; *see also*, Ex. 20 at p. 2-3.

Mr. Ryan offered no opinion as to what a "fair market value replacement salary" for Don may be, because the inquiry is irrelevant in this case. However, he explained that in the closely-held business context, the salaries shareholder-employees receive "varies widely, and it's based more directly on how much value they bring to the company[.]" VRP 6/18/19 at 75:4-14; *see also* Ex. 20 at p.3. Likewise, Ms. Drury agreed that shareholder-employee salaries in such contexts are "very much discretionary when there is a single owner or a majority owner that has control." VRP 6/17/19 at 112:13-16.

Mr. Ryan further explained that it is very common in the closely-held business context for shareholder-employees who contribute more value to a business than other shareholder-employees to be allocated more of the profit of the business in the form of salary instead of dividends because dividends require proportional dividends not tied to the value the shareholder brings to the company. VRP 6/18/19 at 75:15 – 76:3. Mr. Ryan also explained that the differences are more significant as between shareholder-employees who bring great value (like Don) and shareholders who are not employees of the business and bring no value (like the Appellants). VRP 6/18/19 at 76:4-17; Ex. 20 at p.2.

Mr. Ryan further testified that even in the context of determining a “fair market value replacement salary” for Don, Ms. Drury’s analysis was flawed. VRP 6/18/19 at 81:8-20. Among other issues, she failed to interview any current RCDC personnel or Don himself to determine what duties he performs at RCDC. She did not analyze the salaries that businesses of similar size and revenue to RCDC pay their shareholder-employees. She did not determine how Don’s duties increased after Beth and the Appellants abandoned RCDC. And she did not analyze how Don’s efforts and the services he performs for RCDC relates to revenue generation. VRP 6/18/19 at 138:7 – 139:25; Ex. 20 at p. 1-2.

As explained above, Don's total compensation in 2015 and thereafter has in fact decreased from its previous levels. It is no less reasonable now than it was in the years before 2015, when the Appellants believed it was acceptable. VRP 6/17/19 at 45:9-22; 62:9-14. It is the same total compensation, only the way its parts are characterized has changed. The only difference now is that in addition to his own substantial duties, Don performs the duties that Beth and the Appellants performed before they left RCDC. VRP 6/18/19 at 40:9-24; VRP 6/19/19 at 53:5-9; CP 264 (***Finding of Fact No. 20***).

There is overwhelming evidence supporting the trial court's findings and its conclusion that the salary RCDC paid to Don in 2015, and thereafter, is not excessive and is reasonable. CP 264 (***Conclusions of Law Nos. 5 and 7***).

3. The trial court correctly rejected the Appellants' arguments that Don breached his fiduciary duties because changing his compensation to only include a salary and no stock dividend would reduce the value of RCDC.

The Appellants argue that the increase in Don's salary somehow wrongfully diminished RCDC's value. Specifically, the Appellants claim that by Don increasing his salary, he has deprived them of their "rightful" *pro rata* share of RCDC dividends (*i.e.*, he has depleted funds that could be declared surplus and used to make

dividend distributions to them), depleted cash that could be used for company expenses or expansion of the business, and devalued the worth of their shares. Appellants' Brief at P. 35-36. But the Appellants admitted at trial that while they were employed by RCDC they had no objection to Don's total annual compensation. VRP 6/17/19 at 45:9-22; 62:9-14. Further, the undisputed evidence presented at trial is that Don's total annual compensation after the Appellants terminated their employment has either remained nearly exactly the same or has decreased. VRP 6/19/19 at 53:10-14; Ex. 1 at ¶28; Exs. 122-126, 129; CP 263 (***Finding of Fact No. 17***).

Ms. Drury testified that by increasing Don's salary, RCDC likely paid more taxes in the form of increased payroll taxes. VRP 6/17/19 at 121:11-122:23. It is true that when salaries increase, payroll taxes increase. However, Mr. Ryan testified that RCDC experienced no detrimental financial impact whatsoever from this increase because the cash outflow never changed. VRP 6/18/19 at 77:22-78:20. The funds RCDC previously paid to Don as stock dividends are now paid to Don in the form of salary and payroll tax. *Id.*

The Appellants attempt to obfuscate the facts and rely on Ms. Drury's testimony that Don's increased salary "potentially lowers the value of the company, which would lower the value of their percentage interest in the company . . ." VRP 6/17/19 at 118:1-4;

Appellants' Brief at 36. The trial court properly disregarded Ms. Drury's speculative opinion. Moreover, to the extent Ms. Drury's testimony conflicts with the evidence in some way, the Court must defer to the trial court's decision to reject it. *Pilcher*, 112 Wn. App. at 435.

**D. The 2015 Loan Was Not a Disguised Stock Dividend.**

The evidence overwhelmingly supports the trial court's findings and conclusions to the effect that the 2015 Loan was a loan, that it was always intended to be a loan, and that nothing about it was ever "disguised" from the Appellants. CP 263 (*Findings of Facts Nos. 11, 15 and 16*); CP 265 (*Conclusions of Law Nos. 9 and 10*).

The 2015 Loan is the direct result of Don and Beth settling their personal disputes in the divorce proceedings. Don agreed to purchase all of Beth's RCDC shares for approximately \$3,000,000.00. VRP 6/19/19 at 34:2-20; Ex. 1 at ¶16; Exs. 102 and 103. It was understood that Don did not personally have the cash to pay that amount of money, so Beth would be paid through a combination of an assignment of the entire balance of an RCDC brokerage account, and a cash payment in the form of a combination of RCDC cash reserves and the proceeds of a commercial loan, all

of which would be a personal loan to Don that he would repay to RCDC. VRP 6/19/19 at 34:3-8; 35:1-39:4; Ex. 1 at ¶¶17-19; CP 263 (***Finding of Fact No. 11***). And that is exactly what happened.

The 2015 Loan was approved by the shareholders and directors at a special meeting called for that specific purpose, which the Appellants admitted they received advance notice of and chose not to attend. VRP 6/17/19 at 40:21-41:11; 42:2-19; 59:23-60:8; VRP 6/18/19 at 121:18-122:3; VRP 6/19/19 at 46:20-47:16; 47:19-48:2; Ex. 1 at ¶19; Exs. 110 and 111; CP 263 (***Findings of Fact Nos. 15 and 16***).

Don executed a promissory note obligating himself to pay all of the funds back to RCDC, with interest, and has made all of the payments due under the note. VRP 6/18/19 at 60:4-61:16; 65:3-11; 66:4-14; 121:18-23; VRP 6/19/19 at 43:16-44:11; 48:3-16; Ex. 1 at ¶20; Exs. 112, 113 and 126; CP 263 (***Finding of Fact No. 16***).

The Appellants admitted that they knew at the time of the shareholder meeting the funds had already been paid to Beth, that they did not know how the loan was booked in RCDC's accounting records, and that they did not believe the funds were supposed to have been a stock dividend rather than a loan. VRP 6/17/19 at 42:23-43:17; 59:23-61:8.

Not only is there substantial evidence that the funds were a loan, there is no evidence to the contrary.

**E. Don's Decisions Were Good Faith Business Judgments Insulated From Attack.**

The trial court concluded that Don's decisions were all made in good faith, and were reasonable and an honest exercise of his judgment. CP 264-265 (***Conclusions of Law Nos. 3, 6, 7 and 8.***) The Appellants attack these conclusions arguing Don "acted in bad faith and not in the best interests of the Company when he attempted to punish the [Appellants] for siding with their mother during the divorce" and, therefore, the business judgment rule<sup>14</sup> does not apply. Appellants' Brief at 43-44.

The trial court did not find the Appellants' allegations to be true. Instead, the trial court found that Don's total compensation did not change, that his compensation was reasonable and that his decision not to distribute dividends because the Appellants terminated their employment with RCDC was reasonable and made in good faith. CP at 264-265 (***Conclusions of Law Nos. 3, 4, 5, 6,***

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<sup>14</sup> The "business judgment rule" provides that even if Don's conduct was considered oppressive, Don is immunized from liability so long as his decisions are (a) within the power of the company and the authority of management, and (b) there is a reasonable basis to indicate that he acted in good faith. *Scott*, 148 Wn.2d at 709. The Appellants failed to demonstrate that Don's conduct could even be considered oppressive.

**7 and 8.)** To the extent there is any conflicting evidence as the Appellants suggest, the Court must defer to the trial court. *Pilcher*, 112 Wn. App. at 435. The trial court did not commit reversible error by applying the business judgment rule.

**F. Don's Actions Were Not Fraudulent.**

The Appellants argue the trial court incorrectly applied the elements of common law fraud to their claim in reaching its Conclusion of Law No. 9 that "Plaintiffs, minority shareholders failed to prove fraud by clear, cogent and convincing evidence that Defendant Rees deceived them or that he did anything that was procedurally wrong regarding the distribution of salary, the termination of distribution of dividends or the corporation loan he received and paid after his marriage was dissolved." CP at 265 (**Conclusion of Law No. 9**). Specifically, the Appellants argue that the trial court erred by not applying a broader standard of what is considered "fraudulent" under *Sound Infiniti, Inc. v. Snyder*, 169 Wn.2d 199, 237 P.3d 241 (2010). Appellants' Brief at 46-47.

*Sound Infiniti* only applies in cases where a shareholder is exercising dissenter's rights based on very narrowly enumerated

corporate actions<sup>15</sup>, none of which were ever alleged by the Appellants nor are present here. Those corporate actions include such matters as a plan of merger, a plan of share exchange, a sale of all or substantially all of the corporation's assets, or an amendment to the articles of incorporation. RCW 23B.13.020(1)(a-d). Consequently, *Sound Infiniti* is inapplicable.

Assuming, *arguendo*, that *Sound Infiniti* was applicable, the Appellants state Don committed fraud because he "breached the fiduciary duty of good faith and fair dealing by violating the reasonable expectations of a minority shareholder." Appellants' Brief at 47. First, in *Sound Infiniti* the Court concluded "this argument is unpersuasive." *Sound Infiniti*, 169 Wn.2d at 209. Second, the Court still required proof of fraud. *Id.*<sup>16</sup>

Appellants premise their fraud claim on the same actions by Don that underlie their breach of fiduciary duty and oppression claims. As demonstrated above, there is substantial evidence in the

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<sup>15</sup> "The Washington Business Corporation Act (WBCA), Title 23B RCW, provides that shareholders are "entitled to dissent from, and obtain payment of the fair value of the shareholder's shares" when a corporation performs any one of several corporate actions. RCW 23B.13.020(1)." *Sound Infiniti*, 169 Wn. 2d at 206.

<sup>16</sup> Interestingly, the trial court and Supreme Court in *Sound Infiniti* concluded "that in a small, closely held corporation, corporate actions to restore harmonious relations, including ousting those who dislike and distrust the others, are valid." *Id.* at 210.

record supporting the trial court's findings and conclusions that all of those actions were within the power of the corporation and authority of its management to make, that none were concealed from the Appellants, none violated their reasonable expectations as shareholders or otherwise breached a fiduciary duty owed to them or oppressed them, and all were made in good faith for very specific and legitimate business reasons.

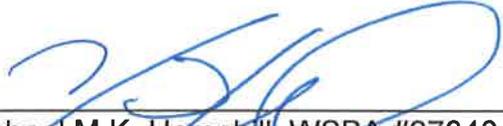
Accordingly, even if the broader notion of "fraudulent" under *Sound Infiniti* should have been applied and the trial court failed to apply it, the trial court still properly dismissed the Appellants' fraud claim. The Court may affirm the trial court's judgment "on any grounds established by the pleadings and supported by the record." *Truck Ins. Exch. v. VanPort Homes, Inc.*, 147 Wn.2d 751, 766, 58 P.3d 276 (2002); *In re Marriage of Rideout*, 150 Wn.2d 337, 358, 77 P.3d 1174 (2003).

## V. CONCLUSION

There is substantial evidence supporting all of the trial court's findings of fact, and those findings support all of its conclusions of law. For the reasons stated above, Respondent Don Rees respectfully requests that this Court affirm Judge Whitener's decision in all respects.

Respectfully submitted this 8<sup>th</sup> day of May, 2020.

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CERTIFICATE OF SERVICE

The undersigned makes the following declaration under penalty of perjury as permitted by RCW 9.72.085.

I am a legal assistant for the firm of Roberts Johns & Hemphill, PLLC. On the 8th day of May, 2020, I caused to be served via email and first class mail a copy of the foregoing document to:

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

Dated this 8th day of May, 2020, at Gig Harbor, Washington.

  
\_\_\_\_\_  
Kristine R. Pyle, Legal Assistant

**ROBERTS JOHNS AND HEMPHILL PLLC**

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