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COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

IN THE COURT OF APPEALS, DIVISION III
OF THE STATE OF WASHINGTON

WASHINGTON TRUST BANK TRUSTEE DELAY, JOSEPH P. DELAY,
PAUL J DELAY, MICHAEL J. DELAY,
Plaintiffs/Respondents,

v.

TRIGEO NETWORK SECURITY INC.,
Defendant/Appellant

APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

In their Response Brief, Respondents (the “Delays”) yet again demonstrate their fundamental misunderstanding of the roles that the Subscription Agreement and Certificate of Designations play in defining the Delays’ substantive rights as shareholders of TriGeo. The Certificate of Designations becomes part of the Articles of Incorporation and supplies the substantive rights of the Delays as shareholders. The Subscription Agreement—the document upon which the Delays rest their entire case—by its terms applies only to the Delays’ acquisition of the shares. In other words, the Subscription Agreement controlled the terms and conditions of the Delays’ commitment, or subscription, to purchase shares of TriGeo. Once the Delays made that purchase, they ceased to be subscribers and became shareholders, and their rights are governed by the Articles of Incorporation, including as amended by the Certificate of Designations.

The Delays also failed to adequately address TriGeo’s argument that the Delays’ lawsuit was not filed until after the statute of limitations had run on their claims. Even conceding the Delays’ position that the Subscription Agreement was a binding contract whose terms continued to apply, TriGeo would have breached the Subscription Agreement, if at all, in August 2004. Therefore, the Delays’ complaint comes too late. Further, the Delays failed to adequately refute that, in voting as common shareholders rather than preferred shareholders, they waived their right to complain about the conversion of their shares that is the subject of the underlying action. Whatever complaint the Delays might have had when TriGeo began to treat the Delays as common shareholders pursuant to the plain terms of the Certificate of Designations, the Delays’ complaint comes far

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too late, and the lower court erred in failing to dismiss the Delays' complaint on those grounds.

II. ARGUMENT

A. **Under Idaho law, the Certificate of Designations governs the terms of the Delays' shares.**

TriGeo does not contest the Delays' oft repeated argument that the Subscription Agreement is a binding agreement. It agrees that the Delays were obligated to pay for, and TriGeo was obligated to issue, the agreed-upon number of preferred shares, as contemplated by the Subscription Agreement. The Delays are wrong, however, that the Subscription Agreement continued to govern the substantive terms of the Delays' shares once those shares were purchased and issued. As discussed more fully in TriGeo's opening brief (see Appellant's Opening Brief, pp.10-13), under Idaho law, the rights of preferred shares are governed by the Articles of Incorporation and Certificates of Designation.

The Certificate of Designations does not modify or amend the Subscription Agreement; rather, they are separate documents that serve different purposes. The Subscription Agreement governed the purchase and issuance of the preferred share, whereas the Certificate of Designations supplies the substantive terms of those preferred shares once issued. For that reason, there was no need to modify the Subscription Agreement in order for the Certificate of Designation to take effect. For that same reason, the Delays' reliance on the Subscription Agreement to supply the substantive terms of the preferred shares is misinformed. The Subscription Agreement, by definition, governs only the acquisition of the shares, not the substantive terms once those shares are issued.

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Stewart v. Estate of Steiner, 122 Wash. App. 258, 93 P.3d 919 (Ct. App. 2004) is inapposite to the case at hand. The investor in *Stewart* sued the stockbroker for allegedly making misrepresentations and failing to disclose certain information to him prior to his subscription and purchase of shares. *Id.* at 263, 93 P.3d at 921. In deciding whether the investor could survive the stockbroker's motion for summary judgment on the investor's cause of action under the Washington State Securities Act (WSSA), the court concluded that the broker was entitled to summary judgment because the investor had signed a subscription agreement in which he warranted that he was not relying on any oral representations in making the decision to purchase the shares. *Id.* at 266-67, 93 P.3d at 923-24. *Stewart* does not stand for the proposition that the Delays were somehow entitled to rely on the Subscription Agreement to supply the substantive terms of the preferred shares. Indeed, *Stewart* supports TriGeo's position that a subscription agreement provides the manner and terms of the sale but not the substantive rights of the security purchased and sold. The issue of whether the Delays relied on the Subscription Agreement for that purpose is not before the court, and in any event, reference to *Stewart* would not assist the court in deciding that question.

The Delays make much ado about the fact that they have not surrendered their preferred stock certificates. It is, however, much ado about nothing. Under Idaho law, shares may be issued without certificates. *See* I.C. § 30-1-626. Section 626 makes clear that substantive rights are established by means other than the certificates themselves.

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The Delays also ask too much of the statement on their preferred stock certificates. The certificate states that it may be *transferred* only by the holder. The Delays contend that this statement prohibits the shares from being *converted* to common shares automatically pursuant to the plain terms of the Certificate of Designations. This argument cannot prevail—a limitation on the transferability of shares simply has no bearing one way or the other on the shares automatic conversion. Notwithstanding the Delays’ disappointment with the outcome, their preferred shares automatically converted to commons shares pursuant to the terms of the Certificate of Designations, and the language included on the preferred stock certificates did not prohibit that conversion.

The Delays also ask too much of the language of the Subscription Agreement itself. They argue that because the Subscription Agreement gave them the right to convert the preferred shares to common shares, they *alone* had the right to convert the shares. But the language of the Subscription Agreement does not purport to make the subscribers’ future right to convert exclusive, and it certainly does not expressly prohibit the shares from converting automatically as provided for in the Certificate of Designations. The Certificate of Designations is in clear compliance with Idaho law. Section 30-1-601(3) of the Idaho Business Corporation Act (the “Act”) provides as follows:

- (3) The articles of incorporation may authorize one (1) or more classes or series of shares that:
 - (a) Have special, conditional or limited voting rights, or no right to vote, except to the extent otherwise provided by this chapter;
 - (b) Are redeemable or *convertible* as specified in the articles of incorporation:

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- (i) At the option of the corporation, the shareholder, or another person *or upon the occurrence of a specified event*;
- (ii) For cash, indebtedness, securities or other property; and
- (iii) At prices and in amounts specified, or determined in accordance with a formula

(emphasis added).

The Official Commentary to Section 601, subsection (3) of the Act states as follows:

Section 601(3) authorizes the creation of classes or series of shares with a *virtually unlimited range of preferences, rights, and limitations*.

(emphasis added).

The terms of the Subscription Agreement and Certificate of Designations are not inconsistent with each other, and the Delays cannot rely on the terms of the Subscription Agreement to somehow render the plain terms of the Certificate of Designation ineffective.

The Delays' citation to *REA Express, Inc. v. Interway Corp.*, 410 F. Supp. 192, 202 (S.D.N.Y. 1976) is irrelevant. *REA Express* does not purport to establish a general principle of law that the conversion of preferred shares in all circumstances requires the consent of the shareholders. Rather, in that case the court was answering the question of whether Interway had breached a contract with REA to register common shares as requested by REA. *Id.* at 202. But before the shares could be registered, they had to be converted from preferred shares, and third parties were the shareholders of record of the preferred shares in

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question. *Id.* According to the terms of the preferred shares in that case, the shareholders' consent was required before the shares could be converted. *Id.* Such is not the case here. The shares automatically converted on a date certain according to the plain terms of the Certificate of Designations; the Delays' consent was not required for that conversion to take place.

The Delays' argument that the Certificate of Designations is void because it is unsupported by consideration is equally unavailing. The cases cited by the Delays stand for the general and unremarkable proposition that a contract modification must be supported by consideration. As noted above, however, the Certificate of Designations did not modify or amend the Subscription Agreement. Instead, the Certificate of Designations, as passed by TriGeo's board of directors, became part of the Articles of Incorporation and governed the substantive terms of the Delays' preferred shares. TriGeo mailed a copy of the Certificate of Designations to the Delays in or around April 2001, and the Delays do not deny receiving a copy of the Certificate of Designations at that time.

B. The Statute of Limitations has run, and the Delays waived their right to protest the conversion of their preferred shares to shares of common stock.

Whatever the form of the Delays' complaint about the conversion of their preferred shares, their complaint is simply brought too late. The Delays argue that their cause of action did not accrue until TriGeo refused to pay them as preferred shareholders as part of the merger with Solar Winds. They are wrong as a matter of law and fact.

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There is no question that the Delays knew that their preferred shares would automatically convert to common shares in August 2004. TriGeo mailed a copy of the Certificate of Designations containing the operative conversion provision in April 2001, approximately 10 years before the Delays filed their action. On its face, the Certificate of Designations states that it governs the terms of the preferred shares. Consistent with the plain terms of the Certificate of Designations, TriGeo mailed a letter to the Delays on August 2, 2004, confirming that their preferred shares had in fact been converted to common shares the day before. The Delays do not deny that they received this letter. At the latest, then, the Delays' cause of action accrued when they received the letter confirming that TriGeo had converted their preferred shares to common shares. The statute of limitations ran on that cause of action in August 2009, approximately two years before the Delays finally filed their lawsuit.

The Delays confuse the issue of whether TriGeo had the authority to convert the shares with the issue of when their cause of action accrued. Whether the Delays are entitled to be compensated for the damages they have incurred for TriGeo's alleged breach of contract has no bearing on the question of when their cause of action accrued. There is no question that TriGeo converted the Delays' preferred shares to common shares and began treating the Delays as common shareholders in August 2004. The Delays' argument that their cause of action did not accrue until July 2011 simply ignores basic corporate law, and violates the policy behind statutes of limitation. The loss of a right to be paid in a corporate liquidation or merger on a preferential basis--which is the essence of preferred stock--is clearly a detriment regardless of the comparative values of the preferred

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stock and the common stock at the time of the ultimate transaction that triggers the payout to the company's shareholders. The "preference" of preferred stock is a fixed amount, contractual in nature, and cannot be diluted by the issuance of additional common stock. In contrast, common stock is totally at risk for dilution by issuance of additional shares of common stock in the discretion of the board of directors. Any preferred stockholder who truly believed that a conversion from preferred to common was wrongful, would immediately, or certainly within the allowable statute of limitations, take action to protect its preference from even the potential for dilution.

If the Delays wanted to complain about the conversion of their preferred shares to common, they could and should have done so any time between August 2004 and August 2009. They failed to do so, and TriGeo was therefore entitled to repose on that issue. The trial court erred in refusing to dismiss the Delays' complaint based on the statute of limitations.

The Delays also waived their right to complain about the conversion of their preferred shares by affirmatively exercising their rights as *common* shareholders. As recognized by the Delays in Respondent's Brief (see page 29), the question of waiver must be decided on the facts and is based on fairness and justice. *See Riverside Dev. Co. v. Ritchie*, 103 Idaho 515, 520-21, 650 P.2d 657 (1982). There is no question that the Delays were aware of the provision in the Certificate of Designations providing for the conversion and that TriGeo began treating the Delays as common shareholders beginning in August 2004. With that knowledge, the Delays executed Waivers of Notice and Ballots that clearly identified them as common shareholders. Although the Delays attempt to

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minimize their waiver based on the location of the identification of their shares below the signature line on the Waivers and Ballots, they do not actually deny that they were aware of the label. Based on these facts, the Delays waived their right to complain about the conversion of their shares.

The Delays cannot negate their actions simply by saying they were entitled to rely on the Subscription Agreement. First, as discussed more fully above, although the Subscription Agreement gave the Delays the option to convert the shares, it did not purport to make that option exclusive. Second, the Delays cannot acknowledge the Certificate of Designations in 2001, receive notification that TriGeo converted their shares in 2004, exercise their rights as common shareholders in 2004, 2005, and 2006, and then try to argue that they did not intend to waive their rights to complain about the conversion of their shares in 2011 when they do the math and realize they would make more in the merger as preferred shareholders. Both fairness and justice compel a finding that, based on these facts, the Delays waived their right to sue over the conversion of their preferred shares to common shares in 2004.

C. The Delays are not entitled to their attorney's fees on appeal.

Unlike the typical case where a plaintiff sues for relief, and then the defendant moves to compel arbitration of that dispute, the only relief requested by the Delays in this matter was for an Order compelling arbitration. The court awarded the Delays the relief they requested in full. Thus, there is nothing left for the trial court to do. Because the Order compelling arbitration in this matter is the functional equivalent of a final judgment, *Catlin v. United States*, 324 U.S. 229, 233 (1945) (“A ‘final decision’ generally is one which ends the litigation on the

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merits and leaves nothing for the court to do but execute the judgment.”), the court’s Order compelling arbitration and dismissing TriGeo’s Motion to Dismiss is appealable as a matter of right. The cases cited by the Delays in their Standard of Review section of Respondents’ Brief do not address this unique factual scenario and have no bearing on whether the Order compelling arbitration in this matter is appealable.

Even if the Court finds otherwise, the Delays are not entitled to any attorney’s fees on appeal because TriGeo’s appeal is not frivolous. All doubts on this issue are resolved in TriGeo’s favor, and the record on the whole must be considered. *Schmerer v. Darcy*, 80 Wn. App. 499, 510-11, 910 P.2d 498 (Ct. App. 1996). As noted in the previous paragraph, this case is atypical procedurally, making the application of traditional rules regarding the appealability of an order compelling arbitration inapplicable to this matter. As the record below indicates, the trial court has done everything the Delays have asked it to do; there is nothing left for the trial court to decide or do. Therefore, even if this Court disagrees with TriGeo’s reasons for filing the appeal, TriGeo’s position is not “so totally devoid of merit that there was no reasonable possibility of reversal.” *Id.* Accordingly, TriGeo asks that this Court deny the Delays’ request for their attorney’s fees on appeal.

III. CONCLUSION

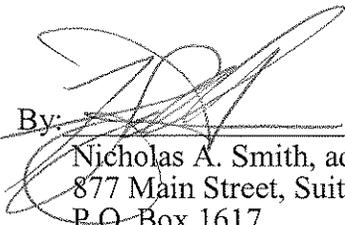
TriGeo respectfully requests that this Court vacate the trial court’s order compelling arbitration and denying TriGeo’s Motion to Dismiss, and remand with instructions to dismiss the Delays’ complaint against TriGeo.

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DATED THIS 14th day of June, 2012.

Respectfully submitted,

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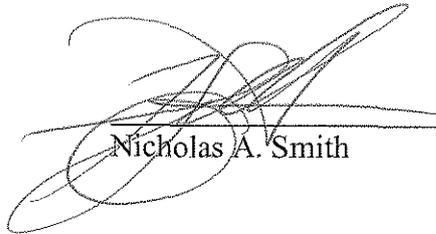
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I HEREBY CERTIFY that on this 14th day of June, 2012, I caused to be served a true copy of the foregoing APPELLANT'S OPENING BRIEF, by the method indicated below, and addressed to each of the following:

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