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No. 57938-0-I

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

GERALD ROBERT KINGEN and KATHRYN KINGEN,
Husband and Wife,
and the Marital Community Comprised Thereof,

and

SCOTT G. SWITZER and CHERI SWITZER,
Husband and Wife,
and the Marital Community Comprised Thereof,

Appellants,

vs.

EUFEMIA "EMMA" MORGAN,
NANCY PITCHFORD, and
DANIEL MCGILLIVRAY,
Individually and on Behalf of all the
Members of the Class of Persons Similarly Situated,

Respondents.

BRIEF OF APPELLANTS

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I. ASSIGNMENTS OF ERROR
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A. Assignments of Error

1. The trial court erred in granting summary judgment in favor of the respondent employees on their claim for unpaid wages, double damages, and attorney fees under RCW 49.52.070, where the record was entirely devoid of evidence to support a finding that Appellants acted “willfully” and with the “intent to deprive” Respondents of wages.

2. The trial court erred in denying Appellants’ counter-motion for summary judgment of dismissal, where the respondent employees failed to establish, *prima facie*, that Appellants acted “willfully” and with the “intent to deprive” Respondents of wages.

3. The trial court erred in rendering judgment in an amount representing not only twice the amount of unpaid wages owed to Respondents, but an additional sum representing double the amount of employment withholding taxes due on such wages, where Appellants remain potentially liable for the payment of those taxes, and where those taxes have been credited to Respondents as a matter of law.

B. Issues Pertaining to Assignments of Error

1. Was there a genuine issue of material fact as to whether Appellants, as “officers, vice principals or agents” of an employer, acted “willfully” and with an “intent to deprive” the respondent employees of their wages? (Assignments of Error No. 1.)

2. Can an officer of a corporate employer be reasonably deemed to have acted "willfully" and with the "intent to deprive" employees of wages where the uncontroverted evidence establishes that (1) at the time of the nonpayment of wages, the officer had been legally divested of any and all control and authority over the conduct of the business and the payment of wages, (2) the decision to forego the payment of wages was made solely by the Bankruptcy Court and the Trustee in Bankruptcy, and (3) the officer consistently opposed, and actively resisted, the decision to forego the payment of wages? (Assignments of Error Nos. 1 and 2.)

3. Can RCW 49.52.050, which expressly predicates liability upon a finding of "willful" conduct specifically "intended to deprive" employees of their wages, reasonably be construed to permit the imposition of liability *per se*, and to dispense with the need for any inquiry into the defendant's actual state of mind? (Assignments of Error Nos. 1 and 2.)

4. Can RCW 49.52.050, which creates liability for willful and intentional withholding of wages by officers and agents of an "employer," be reasonably construed to create liability on the part of corporate officers for acts taken and decisions made solely by the Bankruptcy Court and the Trustee in Bankruptcy after the Trustee has, as a matter of law, succeeded to the status of "employer" and assumed all of the duties and liabilities that would otherwise devolve upon the corporation's officers? (Assignments of Error Nos. 1 and 2.)

5. Inasmuch as the civil penalties provided for by RCW 49.52.070 are specifically predicated upon a finding of criminal liability under RCW

49.52.050, may the former statute be construed so as to negate or render nugatory the legislatively prescribed element of *mens rea*? (Assignments of Error Nos. 1 and 2.)

6. Should the Washington Supreme Court's holding in *Schilling v. Radio Holdings, Inc.*, 136 Wn.2d 152, 961 P.2d 371 (1998) be construed so as to override the express terms of RCW 49.52.050 and .070 and to mandate a finding of liability in a case where the nonpayment of wages, although neither willful nor intended to deprive employees of wages, was due to circumstances other than (1) inadvertence or (2) a bona fide dispute over the liability for wages? (Assignments of Error Nos. 1 and 2.)

7. Should the "wages" to which a prevailing plaintiff is entitled under RCW 49.52.070 be construed to include employment withholding taxes where (1) the defendants remain potentially liable for the payment of those taxes, where (2) the plaintiff employees cannot, as a matter of law, be held liable for those taxes, and where (3) the plaintiff employees will, as a matter of law, receive a credit for those taxes regardless of whether they are paid? (Assignment of Error No. 3.)

C. Standard of Review

The standard of review of an order granting summary judgment is *de novo*. *Herron v. Tribune Pub. Co., Inc.*, 108 Wn.2d 167, 169, 736 P.2d 249 (1987). The Court of Appeals undertakes the same inquiry as the trial court below, and will uphold the judgment only "if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no

genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Id.*; CR 56(c). A factual issue is "genuine," and thus requires denial of the motion, whenever the evidence is such that a reasonable jury could find in favor of the non-moving party. *O'Brien v. Hafer*, 122 Wn. App. 279, 283, 93 P.3d 930 (2004).

In reviewing the grant of summary judgment in favor of a plaintiff, the Court of Appeals will consider at the outset whether the plaintiff met his threshold burden of establishing (1) his entitlement to judgment as a matter of law and (2) the absence of any material factual dispute. Only if it finds that this initial hurdle was cleared will the Court deem the burden of production as having shifted to the defendant to come forward with evidence demonstrating the existence of a genuine issue of material fact. *Hash by Hash v. Children's Orthopedic Hosp. & Med. Ctr.*, 110 Wn.2d 912, 918, 757 P.2d 507 (1998).

In reviewing the denial of a *defendant's countermotion* for summary judgment, the court of Appeals will likewise consider whether the defendant established his entitlement to judgment as a matter of law. *In addition*, however, the Court will consider whether the defendant was entitled to dismissal based upon the alternative summary judgment standard articulated by the United States Supreme Court in *Celotex v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed. 265 (1986), and adopted by the Washington Supreme Court in *Young v. Key Pharmaceuticals*, 112 Wn.2d 216, 225, 770 P.2d 182 (1989) and *Guile v. Ballard Community Hospital*, 70 Wn. App. 18, 21-23, 851 P.2d 689 (1993). Under that standard, a defendant establishes his

entitlement to summary judgment by showing that the plaintiff lacks sufficient evidence to support an essential element of his or her case. In such a situation, there can be no genuine issue of material fact, since “a complete failure of proof concerning an essential element of the [plaintiff’s] case necessarily renders all other facts immaterial.” *Celotex*, 477 U.S. at 322. The defendant need only point out to the trial court those portions of the record which he believes demonstrate that the plaintiff cannot meet his ultimate burden of proof at trial. The burden then shifts to the plaintiff to come forward with competent and admissible evidence sufficient to support a *prima facie* case. *Id.*

II. INTRODUCTION

Appellants Gerald and Kathryn Kingen (“Kingn”) and Scott and Cheri Switzer (“Switzer”), defendants below, hereby appeal the trial court’s decision granting summary judgment in favor of Respondents on their claim for unpaid wages and statutory double damages under RCW 49.52.050 and .070. Those statutes, commonly known as the Wage “Anti-Kickback” Law, permit an individual “officer, vice principal or agent” to be held personally liable for wages owed by an employer upon a showing that the individual acted “willfully” and with an “intent to deprive” employees of wages.

In the present case, there never was any evidence to suggest that the appellants, as officers and agents of the employer corporation, acted “willfully” or with an “intent to deprive” the respondent employees of their wages. The nonpayment of wages at issue in this appeal was the result of a

unilateral decision on the part of the Federal Bankruptcy Court and the Trustee in Bankruptcy made after the corporation was ordered involuntarily into Chapter 7 liquidation. At the time, Appellants were totally removed from any position of control over the business and were divested, as a matter of law, of all authority over the payment of wages.

Nonetheless, the trial court held that it was constrained by the decision of the Washington Supreme Court in *Schilling v. Radio Holdings, Inc.*, 136 Wn.2d 152, 961 P.2d 371 (1998), to apply RCW 49.52.050 and .070 without regard for the legislatively prescribed element of *scienter* and to *impute* to Appellants the mental state necessary to render them liable as a matter of law. In so holding, the trial court seriously misconstrued the import and scope of the Supreme Court's decision in *Schilling*, and as a result expanded the scope of liability beyond anything previously considered by this state's appellate courts. More important, the trial court's decision so distorted the meaning of RCW 49.52.050 as to make it impossible to reconcile with the plain and unambiguous terms of the statute.

This appeal, therefore, presents a fundamental question of statutory construction: Where liability is predicated upon a statute that is clear and unambiguous in its terms, may a court "rewrite" the statute so as to excise from its text the legislatively prescribed element of *scienter*, thereby expanding the scope of liability beyond anything reasonably ascertainable from the language of the statute itself? RCW 49.52.070 specifically requires a finding of "willfulness" and "intent to deprive" employees of wages before a corporate officer or agent can be held personally liable for the wage

obligations of his corporation. Appellants submit that it was not the trial court's prerogative to simply ignore that legislative mandate and to impose upon Appellants the equivalent of strict liability.

Because there was no evidence whatsoever that Appellants took any action--much less willful and intentional action--to deprive the respondent employees of their wages, summary judgment in favor of the employees was erroneously granted. And because the appellant officers lacked, as a matter of law, both the control and authority necessary to support a finding of willfulness and intent, their motion for summary judgment of dismissal was erroneously denied.

III. STATEMENT OF THE CASE

A. Background Facts

This appeal arises out of a class action lawsuit instituted by the former employees of Funsters Grand Casino, Inc. ("Funsters") against two of the corporation's officers and shareholders--Gerald Kingen and Scott Switzer. At issue is approximately \$120,000 in wages and employment taxes, and another \$291,000 in statutory penalties and attorney fees, for which the defendant officers were adjudged personally liable following the discharge of the employees' wage claims in Funsters' Chapter 7 bankruptcy.

In the main, the central facts of this case are not contested. Following is a brief synopsis:

Funsters was a restaurant and mini-casino business established in the summer of 2001 in SeaTac, Washington. It was organized in the form of a

corporation whose shares were owned by the appellants Gerald Kingen (31%) and Scott Switzer (7%), together with their partners Paul Merlino (31%) and Jimmy Harkey (31%).¹ (CP 357-58.) The business was funded with (i) \$3.25 million in capital contributed by the owners, (ii) \$2.5 million in shareholder loans, and (iii) \$7.25 million in bank financing--all of which was personally guaranteed by the owners. (CP 445, 478-79.) Its principals were experienced business people with a solid track record of successes in a variety of business ventures.²

Shortly before Funsters was scheduled to open for business, the company encountered a number of unforeseen financial hurdles, beginning, in the spring and summer of 2001, with repeated construction delays resulting in significant cost overruns. (CP 477.) Opening of the business was significantly delayed, causing the company to lose the majority of the 335 employees that it had hired and trained, and causing it to incur over \$2 million in unexpected carrying costs. (CP 358, 477.)

Despite those initial setbacks, the casino finally opened for business on August 3, 2001. (CP 445.) Revenues were increasing at the rate of 15 to

¹ The original owners consisted of Merlino, Kingen and Switzer. In early 2001, while the casino was still in the process of construction, Harkey joined the ownership group. It is notable that of the four owners, only Kingen and Switzer were made a party to this lawsuit, although between the two of them they held only a minority interest in the business.

² Gerry Kingen was the founder of the well-known Red Robin Gourmet Burger establishment, and currently owns and operates the popular west coast Salty's restaurant chain. Scott Switzer served as a certified public accountant for the firm of Coopers & Lybrand, and later became Chief Financial Officer for Happy Guests International, the management entity for the Salty's chain. Paul Merlino was an experienced businessman and entrepreneur, and his wife, Cheryl, the former president of Trident Imports. Jimmy Harkey was a highly successful executive in the construction and development business with a proclaimed net worth of over \$40 million.

20 percent per week when--hardly one month after the facility opened its doors--the 9/11 terrorist attack on the World Trade Center occurred. (CP 445-46, 477.) Business plummeted overnight as air traffic came to a virtual standstill and hotel occupancy in the SeaTac area dwindled to practically nothing. (CP 365, 389, 446, 479.)

The massive and unexpected business losses attributable to 9/11 and its aftermath threatened to quickly deplete the company's resources. The owners moved swiftly to shore up the business, drastically cutting costs and exploring every possible avenue for increasing revenues. Meanwhile, they commenced an aggressive search for additional financing. (CP 389, 446, 479.) However, in the wake of 9/11, the lending market was effectively frozen. (CP 379-80, 446, 479-80.)

By the end of 2001, the ownership group (which previously had consisted of Kingen, Merlino, and Switzer) was successful in obtaining an additional equity partner, Jimmy Harkey, and an additional \$1.25 million had been infused into the business. (CP 478.) The owners were actively involved in negotiations with additional investors when the governor proposed a 10 percent tax on gross revenues from non-tribal gambling establishments. That proposal, which if enacted would have promptly shut the business down, stood as an additional impediment to institutional lending and put a serious chill on all investor interest. (CP 379-80, 446-47, 480.) In the meantime, the owners poured substantial funds of their own into the company in order to meet its most pressing obligations. (CP 368-71, 381.)

There is no question that during this period of time the business was experiencing severe financial difficulties. A number of the company's obligations--most notably its federal and state tax obligations--became delinquent. (CP 480.) Despite these difficulties, and the need to apportion the company's limited resources among a growing number of obligations, there never was a time that Funsters' employees did not get paid. (CP 448, 473-74, 480.) As Mr. Switzer explained, payroll was always considered "top priority." (CP 369-70, 372, 381, 472-73, 480.)

There certainly were times when cash ran short and paychecks were returned for insufficient funds, but *each and every time those checks were fully, and immediately, covered.* (CP 366, 368, 370, 381, 387-88, 390, 400, 480-81.) Underscoring the commitment of Kingen and Switzer to the success of the business and the payment of wages was the fact that they devoted the majority of their time to the business while never taking a dime of compensation for their efforts. (CP 359, 396, 475, 493.)

Throughout this period of time, Appellants spent innumerable hours taking stock of the company's resources and analyzing its prospects for recovery. (CP 481.) Having invested several million of dollars of their own in the business, and having personally guaranteed millions more in loans, they had every reason and incentive to make a realistic and well considered appraisal of the future of the business. (CP 481.) Their ultimate conclusion was that the business was still viable, and--at the very least--had considerable residual value which should be preserved by continuing to operate. (CP 368, 472, 475.)

By the spring of 2002, Funsters' prospects looked brighter. The aftereffects of 9/11 were dissipating, and the economy appeared to be recovering. (CP 481.) The owners had been successful in obtaining an additional \$2.75 million in personally guaranteed bank financing and had secured a commitment from its principal lender, AEA Bank, to restructure the company's defaulted debt obligations. (CP 147, 481.) That restructuring, however, depended upon the personal guarantees of each of the owners--most notably Harkey, whose net worth and liquidity far surpassed that of any of the other owners. In July 2002, after agreeing to participate in the refinancing, Harkey changed his mind and announced that he wanted out of the business. He proceeded to unilaterally pull the plug on the company's line of credit and made known to its lenders that he intended to walk away from his personal guarantees. That startling and ill-conceived move dealt an enormous, unforeseeable blow to the business. (CP 364-66, 481-82.)

As a result of Harkey's precipitous action, the remaining owners made the decision to put the company into Chapter 11 bankruptcy. (CP 364-65, 482, 469.) They believed that with some time to recapitalize, and with some breathing room from the immense financial pressures that were bearing down, the business could succeed. (CP 482.) Mr. Kingen testified:

We were optimistic. We were doing everything we could to create a success. . . We were giving it everything we had to make it work.

(CP 397.) Weighing heavily into the equation was the fact that the 2002-03 legislative session was about to begin, and there was a strong lobbying effort in Olympia aimed at enacting legislation that would have legalized slot

machines in non-tribal casinos. That legislation, if enacted, would have given the business an enormous shot in the arm and an opportunity to become profitable within a short period of time.³ (CP 364-65, 372, 399, 473, 482.)

Funsters' Chapter 11 filing came as no surprise to the company's employees, who were more than aware that the company was experiencing severe financial difficulties. (CP 375, 378, 405, 415) By plaintiffs' own admission, it had been apparent for some time that Funsters was having difficulty meeting its obligations, and there was a constant tenor of "gossip" about the casino's financial travails. (CP 416.) Just about everybody had an opinion about what was wrong and what should be done to fix it. (CP 483-84.) At no time, however, did any employee ever suggest that the business ought to be shut down.

During this time, Kingen and Switzer made a conscientious effort to keep Funsters' employees apprised of what was going on. Immediately after the bankruptcy filing, they called an all-staff meeting, announced that the company had filed for Chapter 11 protection, and explained what that meant. (CP 398, 416, 473.) A commitment was made to the employees to make every effort to keep the business going. (CP 473.) From that point forward, each of Funsters' managers received regular updates regarding the status of the bankruptcy, as well as copies of all of the notices of motions and hearings. (CP 374-75, 378, 415, 418, 473, 484.)

³ The owners were not, as suggested by plaintiffs in this action, proceeding on a "hope and a prayer." Even the Trustee in Bankruptcy recognized that there was a 70 percent chance that the pending slot machine legislation would pass. (CP 317.)

For the next six months, Funsters continued to operate under the protection of Chapter 11 as a “debtor in possession.” (CP 469.) One of the first things that Kingen and Switzer did after being granted that status was to petition the Bankruptcy Court for an order allowing them to pay Funsters’ employees the pre-petition wages that had accrued during the pay period immediately preceding the Chapter 11 filing. (CP 243-49, 253-55, 449, 485.) A declaration submitted by Funsters in connection with that motion provided an accurate reflection of Appellants’ priorities in this regard. It stated:

Employees would suffer significant hardship, and, in many instances, financial difficulties, if their pre-petition wages were not available to meet their personal obligations. Failure to honor payroll checks already issued would severely damage the Debtor’s relationships with its employees and impair employees’ morale when their dedication, confidence and cooperation is most critical.

(CP 254.) The motion was granted, and Funsters’ employees were paid the full amount of their wages. (CP 259-60.)

Appellants’ commitment to the company’s employees was not just “talk.” During the entire six-month period that Funsters remained in Chapter 11 as a debtor in possession, *there never was a time that its employees did not get paid.* (CP 474, 485.) Kingen and Switzer worked night and day to keep the paychecks coming, without so much as a dime of compensation for themselves, and without any return--*ever*--on their substantial investment. (CP 359, 396, 475, 493.) A number of obligations, including federal and state tax liabilities, went unpaid so that payroll would be met. (CP 448, 485.)

During this period of time, Appellants continued to explore every possible avenue for increasing revenues and for preserving the existing assets

of the business. They drastically cut overhead. (CP 378.) The number of employees was reduced from over 200 (originally 335) to 135--the absolute minimum necessary to keep the business going. (CP 359, 377, 426, 483.) Meanwhile, Appellants continued to scour the landscape for potential equity partners and possible buyers. (CP 368, 483.)

By the spring of 2003, significant progress had been made toward a successful reorganization. A total of \$5.6 million in corporate loans had been wiped off the books as a result of the owners' personal assumption and payment of the debt. (CP 272.) The most pressing and significant legal actions against the company had been resolved. (*Id.*) Substantial additional funds had been infused into the business by the appellants in the form of "debtor in possession" financing. (CP 271, 368-69, 392, 483.) Appellants were involved in negotiations with a number of investors. (CP 486.) Losses had been reduced dramatically, and there had been a 47 percent increase in sales. (CP 271, 380, 486.) Finally, the likely prospect of obtaining slot machines by the end of the legislative session provided realistic hope for a substantial and immediate turnaround. (CP 271-72, 392, 399, 486.) Even plaintiffs' representative, Daniel McGillivray, conceded that it appeared as though the business would finally be able to "pay its own way." (CP 421.)

What had *not* been resolved, however, was a claim for over \$1.6 million in unpaid federal and state taxes, and the IRS was tired of waiting. (CP 400.) In April 2003, the United States Attorney, acting on behalf of the Internal Revenue Service, filed a motion to dismiss the Chapter 11 proceeding. (CP 262-64, 266-67, 449, 486.) Appellants vigorously resisted

the motion and proposed to commit another \$500,000 to the company on a subordinated basis in order to permit the organization to continue for at least the amount of time that it would take to determine the outcome of the pending slot machine legislation. (CP 270-73, 283-314, 392.) Notably, that additional cash infusion would have substantially cured the company's post-petition debt (including *all* of its post-petition tax debt) and provided operating funds sufficient to get the company through the end of the legislative session. (CP 286-88, 300, 392.)

There was yet another consideration that weighed heavily on the minds of the owners and that was brought to the attention of the Bankruptcy Court. The value of the business was almost entirely dependent upon its status as a going concern. (CP 273, 486.) Absent a successful reorganization, there would be no potential for payment to the company's unsecured creditors. (CP 273, 305.) Echoing that concern, the Creditors' Committee strongly urged the court to continue the Chapter 11, arguing that

[i]t is clearly in the interests of unsecured creditors that this case survives. . . The representations that [debtor's attorney] has made I think are very promising. . . There appears to be funds that could bring a tax debt current in a few days. . . [T]he creditors have, really, everything at stake. . . But they have to depend on the debtor to get us there.

(CP 298-99, 366, 487.)

The transcript of the April 7 hearing reveals that the Bankruptcy Court was inclined to grant the company an additional, limited period of time to prove that it could effectively reorganize. (CP 306.) The court took particular note of Mr. Kingen's commitment to contribute to the business--

then and there--sufficient funds to bring all of the company's post-petition tax obligations current. (CP 286-88, 309-10, 366, 370-71.) However, yielding to pressure from federal and state taxing authorities, who contended that it would just be a matter of time before they'd all be back in court again (CP 296, 306), the Bankruptcy Court rejected Funsters' plea for additional time. However, instead of dismissing the action, as was being urged by the United States Trustee, the court surprised everyone by instantaneously converting the proceeding into a Chapter 7. (CP 280-81, 286-88, 292, 296, 306, 309-10, 366, 370-71, 487.)

Within a *half hour* of the court's order, the Chapter 7 Trustee, Michael McCarty, was on the premises of the casino. (CP 375.) He took physical possession of the company's books and records, and emptied the casino of every dollar of cash that it had on site. (CP 317, 421-22, 469.) He proceeded from there to close all of the company's bank accounts--*including the payroll account earmarked for the payment of employee wages*. (CP 360, 438, 469, 474, 488.) In an instant, the business was permanently shut down, and the owners were stripped of any and all control or authority over it. (CP 372, 387, 393, 397, 474.)

The Trustee walked away that day with approximately \$100,000 in cash assets alone. (CP 469.) Those funds were unquestionably more than sufficient to cover the approximately \$14,500 in outstanding payroll checks that had been issued the preceding March 28, 2003 payday. (CP 361, 367, 488.) Together with the revenues that would normally have been generated throughout the remainder of the week, they would also have been adequate

to meet the upcoming (April 11) net payroll obligation of approximately \$90,000. (CP 489, 317.) Kingen and Switzer had every expectation that the funds sequestered by the Chapter 7 Trustee would be used first to meet the company's remaining payroll obligations, just as they had been during the entire two years that the company remained in operation. (CP 381, 491.) Notably, at the time of the Chapter 7 Trustee's takeover of the business and its assets, Funsters was entirely current with respect to its payroll obligations. (CP 473-74, 488-89, 1585.)

Within a matter of days of the court's order, however, a number of the payroll checks that had been issued the preceding payday began showing up returned for insufficient funds--a consequence of the fact that the Trustee had emptied the company's payroll account. (CP 360, 367, 363-64, 489.) Appellants found themselves helpless to do anything about the situation, having been bluntly informed that they were no longer in control of the organization and that they lacked the authority to so much as write a check.

Mr. Kingen committed to the employees that he would make every effort to see that the funds in the possession of the Trustee were used to cover the outstanding paychecks and to meet the company's upcoming payroll obligation. (CP 489.) Meanwhile, he and Switzer aggressively lobbied the Trustee to consider an "operating Chapter 7," which would have allowed wages to be paid as a normal operating expense. (CP 317, 337, 366, 395, 423, 474.) The record reveals that the Trustee was actively exploring that possibility but that the logistics of obtaining a gambling license for the bankruptcy estate rendered the plan unfeasible. (CP 490.)

On April 10, 2003, at the urging of Kingen and Switzer, the Chapter 7 Trustee brought a motion before the Bankruptcy Court asking that the available cash assets of the estate be used to pay the employees their wages, and that the owners' own "superpriority" liens for debtor-in-possession financing be subordinated to achieve that result. (CP 316-19, 372, 391, 469, 474.) The motion was vigorously supported by the appellants Kingen and Switzer, as evidenced by the transcript of the hearing and by the declaration of the Chapter 7 Trustee. (CP 450, 469, 474.) It was opposed by Mr. Merlino,⁴ who vigorously objected to the prospect of putting the employees ahead of his own "superpriority" lien for debtor-in-possession financing. (CP 324-28, 394, 429, 450-51, 469.) Ironically, Mr. Merlino was never made a defendant to this action.

Joining Mr. Merlino in his objection to the motion was the United States Trustee, who stood firm its position that the priority claim of the IRS should take precedence over the employees' wages. (CP 321-22, 469.) In view of the objections, the court reluctantly denied the motion, observing that it was precluded by law from putting the employees' wages ahead of other Chapter 11 administrative expenses. (CP 330-31, 352-53, 469-70, 474, 490.)

As a result of the Bankruptcy Court's decision, none of the outstanding wages were paid, and the employees' claims were subsequently discharged. (CP 386.) Significantly, the owners fared worse. They, too, walked away empty-handed, while being simultaneously left holding the bag

⁴ By that time, Mr. Merlino had also "jumped ship" and had severed ties with Kingen and Switzer.

for over \$7 million in personally guaranteed debt and another \$1.25 million in federal and state taxes. (CP 360.)

When the employees learned that their wage claims were not going to be paid, the employees turned on Mr. Kingen, demanding that he *personally* pay the wages that had been left unpaid by the Bankruptcy Court. A group of employees went so far as to picket a totally separate restaurant establishment owned by Mr. Kingen--Salty's at Alki--falsely proclaiming that he was engaging in unfair labor practices by refusing to pay wages. (CP 374, 451, 492.) When Mr. Kingen failed to capitulate to the employees' demands, this action ensued.

B. Proceedings Below

The lawsuit commenced by the plaintiff employees was a class action brought under RCW 49.52.050 and 49.52.070. At issue was approximately \$120,000⁵ in wages and employment taxes which remained unpaid in the wake of Funsters' Chapter 7 bankruptcy, as well as statutory double damages and attorney fees. (CP 121.)

During the course of litigation, the plaintiff employees made no serious attempt to establish the requisite elements of liability expressly set forth in the statute--namely, a finding of "willfulness" and "intent" to deprive employees of their wages. (CP 115-32.) Instead, they relied upon a flawed

⁵ Plaintiffs' original claim was for approximately \$180,000 in unpaid wages. Through discovery, it was established that approximately one-third of the wages initially claimed by the plaintiff employees (amounting to approximately \$60,000) were not "unpaid" at all. In particular, a significant proportion of the gross wages alleged to be due constituted cash tips that had already been received by the employees. (CP 1072, 1074-77, 1181.)

and unduly expansive reading of the Washington Supreme Court's decision in *Schilling v. Radio Holdings, Inc.*, 136 Wn.2d 152, 961 P.2d 371 (1998). That case, the plaintiffs argued, requires a court to *impute* to an officer or agent the requisite element of *scienter* in all cases except those in which the nonpayment of wages results from one of two discrete circumstances: (1) carelessness or (2) a bona fide dispute over the obligation to pay wages. (CP 126-31, 2526-33.)

In July 2004, the plaintiff employees brought a motion for summary judgment seeking a determination of liability on the part of Kingen and Switzer under RCW 49.52.050 and .070. (CP 115-32.) The trial court, focusing on the decision in *Schilling*, held that it was constrained by that decision to forego any actual inquiry into the defendants' state of mind and to *impute* to them, as a matter of law, the "willfulness" and "intent" necessary to support liability. (CP 1577-62, 1639-54). The court proceeded--despite the lack of *any* actual evidence of willfulness or intent on the part of defendants--to grant plaintiffs' motion for summary judgment. (CP 551-52, 1577-1663.) From there, the court proceeded to adjudicate the issue of damages, ultimately finding defendants to be liable to plaintiffs for \$120,714 in unpaid wages and employment taxes, and another \$291,624 in statutory double damages, interest, and attorney fees. (CP 1681.) Defendants appealed.

IV. ARGUMENT

A. The Respondent Employees' Motion for Summary Judgment Was Erroneously Granted, and the Appellant Officers' Countermotion Erroneously Denied, Because of the Complete Lack of Evidence That Appellants Acted "Willfully" and With an "Intent to Deprive" the Respondent Employees of Wages.

RCW 49.52.050 and .070 together define the one circumstance under which an "officer, vice principal or agent" may be held personally liable for an employer's unpaid wage obligations. RCW 49.52.050 provides:

Any employer or officer, vice principal or agent of any employer, whether said employer be in private business or an elected public office, who . . . (2) willfully and with intent to deprive the employee of any part of his wages, shall pay any employee a lower wage than the wage such employer is obligated to pay such employee by any statute, ordinance, or contract. . . shall be guilty of a misdemeanor.

[Emphasis added.] RCW 49.52.070 provides a corresponding--and directly linked--civil remedy for violation of that section:

Any employer and any officer, vice principal or agent of any employer who shall violate any of the provisions of subdivisions (1) and (2) of RCW 49.52.050 shall be liable in a civil action by the aggrieved employee or his assignee to judgment for twice the amount of the wages unlawfully rebated or withheld by way of exemplary damages, together with costs of suit and a reasonable sum for attorney's fees: PROVIDED, HOWEVER, That the benefits of this section shall not be available to any employee who has knowingly submitted to such violations.

Under the express terms of RCW 49.52.050 and RCW 49.52.070, an individual officer or agent of a corporate employer is not automatically liable for the corporation's wage obligations toward its employees. He may be held personally liable for unpaid wages (together with the corresponding penalties)

only where the nonpayment results from *willful conduct specifically intended to deprive employees of wages*.

Whether an officer or agent acts with the necessary *scienter* to render him personally liable under RCW 49.52.050 and .070 is a question of fact. Accordingly, it may be resolved on summary judgment only where the facts are undisputed and where reasonable minds could reach but one conclusion from the evidence. *Dice v. City of Montesano*, 131 Wn. App. 675, 683, 128 P.3d 1253 (2006); *Flower v. T.R.A. Industries, Inc.*, 127 Wn. App. 13, 25-26, 111 P.3d 1192 (2005).

In the present case, the evidence did not even begin to support the finding that Appellants Kingen and Switzer acted “willfully” and with an “intent to deprive” the company’s employees of wages. It is uncontested that the nonpayment of wages here at issue did not occur until after Funsters had been ordered into Chapter 7 bankruptcy and a court-appointed trustee had assumed exclusive control over the company’s operations and assets. At that point, Kingen and Switzer were *legally divested* of all control and authority over the business and had no ability to pay wages--or anything else.

1. Because Kingen and Switzer Had No Control or Authority Over the Payment of the Employees’ Final Wages, Their Failure to Pay Them Could Not Possibly Have Been “Willful” and “Intended to Deprive” the Employees of Wages.

It is important to appreciate that the majority of the wages claimed by the respondent employees (approximately 90 percent of the amount claimed) represented work performed during the final two weeks of Funsters’ existence. It is undisputed that the wages accrued during that final pay period

were not even due to be paid until April 11, 2003--four days after the Bankruptcy Court's April 7 order requiring the immediate liquidation of all of the company's assets. (CP 121, 397, 1584, 2525.) The remainder of the wages claimed by the employees (approximately 10 percent) represented outstanding payroll checks from the preceding pay period ending March 28, 2003 which remained uncashed at the time the Trustee's precipitous emptying of the company's payroll account. (CP 121, 2525.) This is an extremely significant fact, inasmuch as it establishes that the "failure to pay" alleged in this action did not occur until *after* the April 7, 2003 order forcing Funsters into Chapter 7 bankruptcy--when Kingen and Switzer had no control or authority over the management of the business and the payment of wages. It is undisputed that prior to April 7, Funsters was entirely current with respect to its payroll obligations. (CP 473-74, 488-89, 1585.)

What happened in the wake of the Bankruptcy Court's April 7 order is similarly beyond dispute. The Chapter 7 Trustee assumed immediate and exclusive control of the business. He seized all of the cash on its premises, emptied all of its bank accounts, and took physical possession of its books and records. From that point forward, Kingen and Switzer had no control whatsoever over the disposition of Funsters' assets or the payment of its obligations. Mr. Kingen succinctly described the situation as follows:

The operation was totally out of [our] control at that point in time. McCarty walked in half an hour after the Court made its decision and locked the doors and took over everything. There was nothing anybody else could do unless McCarty either did it or directed it to be done, so we were out. We played no role.

(CP 397; *see also* CP 393, 387.)

Not only were Kingen and Switzer deprived, by the Trustee's action, of any and all practical control over the company's assets, the Bankruptcy Court's order converting the proceeding to a Chapter 7 caused them to be *legally divested* of any and all authority over the management of the business and the payment of its obligations. 11 U.S.C. § 541(a)(1) (providing that the commencement of an action in bankruptcy creates an estate consisting of all of the debtor's legal and equitable interests in property); *In re Yonikus*, 996 F.2d 866, 869 (7th Cir. 1993) (holding that "virtually all" of the property of the debtor becomes the property of the bankruptcy estate); *Stumpf v. Albracht*, 982 F.2d 275, 277 (8th Cir. 1992) (holding that a trustee in bankruptcy "stands in the shoes of the debtor, and succeeds to all the assets of the bankruptcy estate"); *Log Furniture, Inc. v. Call*, 180 Fed. Appx. 785, 787-88, 2006 W.L. 1285025 (10th Cir. 2006) (holding that the assets of the bankruptcy estate are within the sole control of the Trustee in Bankruptcy, and that it is antithetical to the concept of a Chapter 7 liquidation for the debtor's managers to attempt to control the property of the estate); *Miller v. Pacific Shore Funding*, 287 B.R. 47, 49-50 (D.Md. 2002) (holding that with the commencement of a bankruptcy action the debtor surrenders the right to dispose of or otherwise control the estate property).

Because Kingen and Switzer lacked both the ability and the *legal authority* to pay the wages claimed by the respondent employees, it necessarily follows that their failure to do so cannot possibly be regarded as evincing willful conduct intended to deprive Funsters' employees of wages.

To hold otherwise would require the Court to so distort the ordinary meaning of “willfulness” and “intent” as to render those terms entirely meaningless.

Precisely that view was expressed by the Washington Supreme Court in the recent case of *Ellerman v. Centerpoint Prepress, Inc.*, 143 Wn.2d 514, 22 P.3d 795 (2001). There, the Court held that the elements of *control* and *authority* are indispensable prerequisites to a finding of liability under RCW 49.52.050 and .070. It stated:

In our judgment, the statutes in question require more than the establishment of an agency relationship. Rather, there must be a showing that an agent had some control over the payment of wages before personal liability attaches to the agent of an employer for the employer’s nonpayment of wages to an employee.

143 Wn.2d 522-23. The *Ellerman* court proceeded to examine the purpose and policies behind RCW 49.52.050 and .070 and concluded that the critical element of *scienter* required by the express terms of the statute could logically be found to exist only where the agent (1) “exercised control over the direct payment” of the particular funds at issue and where the agent (2) “acted pursuant to that authority.” *Id.* at 521-22.

Although the Washington courts have not yet had occasion to apply this principle to the particular situation at bar--where a corporate entity’s bankruptcy divests its officers and agents of any and all control and authority over the payment of wages--the federal courts have dealt with precisely that situation on a number of occasions in cases arising under analogous wage and benefit statutes. Uniformly, those courts have adhered to the same view as expressed by the Washington Supreme Court in *Ellerman*--that because

bankruptcy divests a corporation's officers and agents of all control and authority over the payment of wages, the very justification for holding them personally liable is lacking.

In *Belcufine v. Aloe*, 112 F.3d 633 (3d Cir. 1997), for example, the issue was whether the managers of a bankrupt corporation could be held personally liable under Pennsylvania's Wage Payment and Collection Law for benefits earned by the corporation's employees prior to its bankruptcy but not yet payable until after the bankruptcy filing was effected--when by law the managers had no discretion to direct payment of the benefits. Although Pennsylvania's wage payment statute specifically defined the term "employer" so as to include a corporation's top officers, the Third Circuit nonetheless held that liability could not attach to the defendants because the corporation's bankruptcy prevented them from being "active decisionmakers" with respect to the payment of the particular benefits at issue:

[Here, the company] was current on its payments to the employees up to the point of filing for bankruptcy. Once [the company] filed for bankruptcy, however, the management no longer had the power to choose not to use the corporation's funds to pay wages. Specifically, once [it] went into bankruptcy, bankruptcy law compelled it to refrain from paying the employees' claims. In this context, it is easy to see that the management was not in the position of an "active decisionmaker" vis-a-vis choosing not to pay employees benefits that technically became due in the post-petition period.

112 F.3d at 640. The court observed that to hold a corporation's officers individually accountable for the payment of wages and benefits *that the law prevents them from paying* would run counter to the basic policies underlying the state's wage enforcement statute:

Pennsylvania's purpose in holding the agents and officers of a corporation liable for unpaid wages and benefits is to give those agents and officers an incentive to pay wages and benefits while the corporation still has the resources to do so. Put differently, the WPCL seeks to deter corporate managers from diverting corporate funds that are meant to go toward paying wages and benefits. . .

Given that the purpose of the WPCL is to deter managers from strategically diverting company resources away from the payment of wages and benefits, it makes sense for the WPCL to apply in only those contexts in which the managers have room to behave strategically. Indeed, the courts have applied the WPCL in precisely this manner.

In *DeBrecini v. Graf Bros. Leasing, Inc.*, 828 F.2d 877 (1st Cir. 1987), the First Circuit considered a similar question: whether the definition of "employer" under the Multi-Employer Pension Plan Amendments Act (MPPAA) could be construed so as to render a corporation's sole shareholder personally liable for the withdrawal liability of his bankrupt corporation. The First Circuit held that it could not, reasoning that withdrawal liability is most likely to arise in the context of a corporation's bankruptcy, when its officers and shareholders have no control over payments to creditors. Notably, the Court specifically distinguished the usual situation in which an officer or agent becomes liable for a corporation's wage and payroll tax obligations. In the latter case, the Court observed, the officer *has a choice* whether to pay or not to pay and makes a *conscious decision* to prefer some other creditor over the payment of wages. *See also Glover v. S.D.R. Cartage Co., Inc.*, 681 F. Supp. 1293, 1296 (N.D. Ill. 1988) (holding, in an action brought under the MPPAA, that it is the ability of a corporation's officers to decide whether to make the payments that justifies holding them personally liable).

The foregoing decisions make clear that the *very justification* for holding officers and controlling shareholders liable for a corporation's unpaid wage obligations rides on the premise that those persons have the control and authority to decide whether wages are paid. As the courts have observed, however, the situation is quite different once a company goes into bankruptcy and its officers and agents lose all control and authority over the conduct of the business and the payment of wages. At that point, the justification for holding officers and agents personally liable no longer pertains.

In sum, the elements of control and authority over the payment of wages are indispensable prerequisites to a finding of personal liability under RCW 49.52.070. As observed by the Washington Supreme Court, as well as a number of federal courts, those elements are indisputably lacking once a corporation goes into Chapter 7 bankruptcy and its officers and agents no longer have any *right* to direct the payment of wages. Here, the alleged nonpayment of wages did not occur until after Funsters had been ordered into Chapter 7 bankruptcy--at which point Kingen and Switzer were divested of any and all control over the business and lacked both the practical ability and the *legal authority* to pay wages. Under *Ellerman*, the absence of control and authority rendered Kingen and Switzer incapable, as a matter of law, of depriving Funsters' employees of wages and negated any possible inference that the nonpayment was the result of willful and intentional action.

2. Nothing in the Washington Supreme Court's Holding in *Schilling* Creates a *Per Se* Rule of Liability or Obviates the Need for a Factual Finding of Willfulness and Intent on the Part of an Officer or Agent Alleged to be Liable Under RCW 49.52.050 and .070.

The respondent employees appear to acknowledge the absence of evidence to support a finding of willful and intentional conduct on the part of Kingen and Switzer. Indeed, Respondents devoted the near entirety of their summary judgment motion below to the argument that an actual finding of willful and intentional conduct is not necessary to establish liability under RCW 49.52.050 and 070. (CP 115-33, 2520-48.) In support of that contention, Respondents relied entirely upon the case of *Schilling v. Radio Holdings, Inc.*, 136 Wn.2d 152, 961 P.2d 371 (1998). According to Respondents, that case *mandates* the finding of liability in any case where the nonpayment of wages resulted from something other than (1) carelessness or (2) a bona fide dispute over the employer's obligation to pay wages.

We take vigorous exception to the employees' unjustifiably expansive reading of *Schilling*, which would all but obliterate the *scienter* requirement expressly set forth by the Washington Legislature and create a *per se* rule of liability for officers and agents of a corporate employer. Appellants further take issue with the employees' ill-fitting attempt to apply the holding of *Schilling* to the particular facts at bar.

The *sole* issue before the Court in *Schilling* was whether a corporate officer whose deliberate and calculated choice to forego the payment of employees (and whose conduct was *as a matter of fact* both willful and intended to deprive employees of wages) should nonetheless be insulated

from liability under RCW 49.52.070 by virtue of the corporation's alleged insolvency. The Court in *Schilling* rejected the officer's novel "insolvency" defense, holding that RCW 49.52.070 imposes liability for willful and intentional conduct subject to only one expressly articulated defense: that the employee knowingly submitted to the withholding of wages. 136 Wn.2d at 378. In so holding, the Court specifically declined to deviate from the plain and unambiguous terms of RCW 49.52.070, which compels a finding of liability in any case where there is a "willful" and "intentional" withholding of wages.

Contrary to the position advanced by Respondents, the Court in *Schilling* did not establish a *per se* rule of liability or declare that it is no longer necessary to inquire into whether the withholding of wages was the result of willful, intentional conduct. Nor did it even begin to address the question whether willful, intentional conduct can be found to exist where the nonpayment of wages occurs in the context of a bankruptcy proceeding, when the corporation's officers have been *legally divested* of any and all control and authority over the conduct of the business and the payment of wages.

The respondents' contention that *Schilling* created a *per se* rule of liability, subject to two judicially created "exceptions," is not supported by a thoughtful reading of that case. Because the defendant in *Schilling* had engaged in conduct that *as a matter of fact* was found to be both deliberate and flagrantly calculated to deprive the company's employees of wages, the Court had no need to create a rule of absolute liability. What the *Schilling* court did was to simply observe that in *prior cases*, the only circumstances

in which willfulness was not found to exist involved instances of carelessness or a bona fide dispute over the obligation for wages. 136 Wn.2d at 160. Significantly, the Court did not foreclose the finding of other situations, yet to be presented, in which the courts might find an absence of willfulness or intentionality.

Indeed, the *Ellerman* case, cited previously, provides an example of just such a circumstance. Decided by the Washington Supreme Court three years *post-Schilling*, *Ellerman* expressly excepted from the reach of RCW 49.52.070 the circumstance in which an individual lacks sufficient control and authority over the payment of wages to have acted “willfully” and with an “intent to deprive” employees of wages. 143 Wn.2d at 521 (“[W]e conclude that a vice principal cannot be said to have willfully withheld wages unless he or she exercised control over the direct payment of the funds and acted pursuant to that authority”).

Furthermore, the suggestion that *Schilling* created a *per se* rule of liability subject to two isolated “defenses” is flatly and diametrically opposed to the express language of the statute itself. Under RCW 49.52.050, the dual elements of “willful” conduct and an “intent to deprive” employees of wages are *essential elements of liability* requiring proof by affirmative evidence. Significantly, neither RCW 49.52.050 nor RCW 49.52.070 so much as *mentions* the terms “carelessness” or a “bona fide dispute”—much less makes them “exceptions” or “defenses” to an otherwise irrebuttable presumption of liability.

Even a broad and liberal construction of RCW 49.52.050 cannot negate or diminish the import of these pivotal, and very specific, elements of liability. The term “willful,” as used in RCW 49.52.050 requires that the failure to pay have been “volitional” in the sense that the person “knows what he is doing, intends to do what he is doing, and is a free agent.” *Schilling*, 136 Wn.2d at 159-60. The word “intent,” as in the term “intent to deprive,” requires that the person have acted with the *objective or purpose* of bringing about a particular result. RCW 9A.08.010(a)⁶; *State v. Wilson*, 125 Wn.2d 212, 217, 883 P.2d 320 (1994). Both of these elements require a subjective, individualized assessment of the actor’s mental state and a *factual finding* of the requisite element of *scienter*. See *Flower*, 127 Wn. App. at 37.

For a court to construe the term “intent” so broadly as to encompass *every conceivable mental state* except for two would be so flatly contrary to the plain and unambiguous terms of RCW 49.52.050 as to turn the statute on its head. Such a construction would create an irrebuttable presumption of culpability in all cases that happen *not* to involve an issue of carelessness or bona fide dispute, and as such would run counter to the very concept of specific intent. This is a particularly significant point because RCW 49.52.050 is a *criminal* statute. Accordingly, the requirement of mens rea specifically intended by the Legislature cannot easily be swept under the rug.

Indeed, had the Court in *Schilling* intended the expansive and far-reaching interpretation of RCW 49.52.050 urged by the employees, it would

⁶ RCW 9A.08.010(a) provides that “[a] person acts with intent or intentionality when he acts with the objective or purpose to accomplish a result which constitutes a crime.”

have had to substitute its judgment for that of the Legislature and literally rewrite the statute. And this, the Court has repeatedly made clear, it is unwilling to do. Time and time again the Washington Supreme Court has held that it will not substitute its judgment for that of the Legislature on matters of public policy. *Fritz v. Gorton*, 83 Wn.2d 275, 301, 517 P.2d 911 (1974); *Jones v. Jones*, 48 Wn.2d 862, 869, 296 P.2d 1010 (1956). That fundamental precept has been consistently reflected in the oft-cited rule that when a statute is clear and unambiguous on its face, it is not subject to judicial “interpretation.” Its meaning is to be derived solely from the express language of the statute itself. *Cerrillo v. Esparza*, - Wn.2d -, 142 P.3d 155 (2006); *Hi-Way Fuel Co. v. Estate of Allyn*, 128 Wn. App. 351, 358, 115 P.3d 1031 (2005).

In view of the Washington Supreme Court’s consistent refusal to substitute its judgment for that of the Legislature, and its declared unwillingness to construe a statute in a manner inconsistent with its plain meaning, it cannot reasonably be inferred that the Court in *Schilling* proceeded--like a bull in a china shop--to do exactly that. It is equally implausible, in light of the criminal penalties associated with RCW 49.52.050, that the Court intended to virtually obliterate from the statute the essential element of mens rea. To read *Schilling* otherwise would require this Court to ignore the most basic rules of statutory construction.

It is significant that the Court in *Schilling* went out of its way to disapprove a “rewriting” of the statutes at issue. After expressly refusing to deviate from the plain and unambiguous terms of the statutes, it stated:

The Legislature is, of course, free to add a further exception⁷ to the double damages provision of RCW 49.52.070 if it so chooses. However, we are not free to engraft such an exception to the statute where the plain language of the statute is to the contrary.

136 Wn.2d at 164-65. The Court went on to hold that

when the language of a statute is unambiguous, courts may not alter the statute's plain meaning by construction.

Id. at 165.⁸

The above-quoted passage from the Court's holding in *Schilling* flatly and totally belies Respondents' contention that the Court's purpose in that case was to "write out" of RCW 49.52.050 the legislatively mandated elements of *scienter* and to substitute a *per se* rule of liability subject to only two judicially-created exceptions.

⁷ The Court was not referring to an "exception" to a rule of *per se* liability, as urged by Respondents. The *Schilling* Court specifically clarified that the "exception" to which it was referring was the "specific exception to the double damages requirement of the statute for an 'employee who has knowingly submitted to such violations.'" 136 Wn.2d at 165 n. 6.

⁸ Even if the Court in *Schilling* had been inclined to "construe" RCW 49.52.050 and .070, it would have been constrained to do so in a manner consistent with the text of the statute. And as the United States Supreme Court has observed, the fact that a provision imposes a penalty and is violated by a "willful failure" is itself strong evidence that it was not intended to impose liability without personal fault. *Slodov v. United States*, 436 U.S. 238, 254, 98 S.Ct. 1778, 56 L.Ed.2d 251 (2000).

Furthermore, the foremost objective of statutory construction is to effect the intent of the Legislature. *Reid v. King*, 35 Wn. App. 720, 722, 669 F.2d 502 (1983). Had the *Schilling* court reviewed the legislative history of RCW 49.52.050, as it undoubtedly did, it would have found that the statute (often referred to as the "anti-kickback statute") was enacted to curtail the deliberate and abusive withholding of wages that by the late 1930s had become commonplace in the labor-management setting--most notably the practice of coercing rebates from employees in order to circumvent collective bargaining agreements. See *Cameron v. Neon Sky, Inc.*, 41 Wn. App. 219, 222, 703 P.2d 315 (1985). Accordingly, it was the very purpose of the statute to specifically target and penalize that conduct which was "willful" and "intended to deprive" employees of wages.

We strongly reiterate that the Court's actual holding in *Schilling* was quite limited in scope and did not even purport to address the issue presently before the Court. The sole issue presented in *Schilling* was whether the alleged insolvency of an employer, and its consequent inability to pay wages, would preclude a finding of willful and intentional conduct *under circumstances where the elements of willfulness and intentionality would otherwise be found to exist*. Notably, the court in *Schilling* specifically found that the defendant in that case had made a conscious and deliberate choice to pay other creditors instead of the company's employees--going so far as to actually raid the company's payroll account to settle a sexual harassment claim that threatened to cause him and his wife considerable embarrassment and expense. It observed:

Bingham made choices to pay other creditors before Schilling. Moreover, Bingham made a decision to invade the \$25,000 wage fund to pay a sexual harassment settlement against another employee and Radio Holdings rather than pay Schilling. Where he and his wife were sole shareholders of Radio Holdings, Bingham personally benefitted from this invasion of the wage fund to settle a potentially embarrassing and expensive claim against the corporation. *These financial decisions would appear to belie the financial inability of Bingham and the corporation to pay Schilling. Instead, they demonstrate Bingham and Radio Holdings made volitional financial choices not to pay Schilling.*

136 Wn.2d at 164 n. 5. Significantly, the Court never purported to address the fundamentally distinct issue that arises where, as here, there is no evidence of willful or intentional conduct to begin with, and where the employer's bankruptcy has divested its officers and agents of all control and authority over the management of the business and the payment of wages.

A critical reading of the Court's opinion in *Schilling* reveals how completely inapposite it is to the case at bar. In *Schilling*, the corporate employer was not in bankruptcy, and the defendant retained complete and exclusive control and authority over the management of the business and the payment of wages. In fact, it was in an exercise of that authority, and as a result of a conscious and self-serving decision to forego the payment of wages, that the plaintiff in *Schilling* was caused not to be paid. Accordingly, *Schilling* could not provide a more prototypic example of a case which *on its facts* shows the subjective elements of willfulness and intentionality required by RCW 49.52.050 and .070.

The present case involves none of those defining features. In stark contrast to the facts in *Schilling*, Kingen and Switzer never relied upon Funsters' insolvency as an excuse for an intentional decision to forego the payment of employees. *They never made such a decision to begin with.* They had no right to. The undisputed evidence reveals that the decision to forego the payment of the employees was made solely by the Bankruptcy Court and the Chapter 7 Trustee during a period of time that Kingen and Switzer had no control over the company and lacked both the practical ability and the *legal authority* to pay wages. The uncontested evidence shows that Kingen and Switzer resisted that decision every step of the way.

In sum, *Schilling* does nothing to alter the basic elements of liability specifically set forth in RCW 49.52.050: (1) "willful" conduct and (2) the "intent to deprive" employees of wages. Here, the respondent employees did not even begin to meet their burden of establishing those essential elements

of liability and thus had no need to invoke a judicially-created "defense." Accordingly, *Schilling* has no application to the case at bar.

3. Because Kingen and Switzer Were Not Officers or Agents of an "Employer" at the Time of the Alleged Nonpayment of Wages, They Cannot Be Held Personally Liable For those Wages Under RCW 49.52.050 and .070.

The personal liability created by RCW 49.52.050 and .070 applies, by the terms of those statutes, only officers, agents, or vice-principals of an "employer." While there is no debate about Kingen's and Switzer's status during the time that Funsters remained in operation, that period of time is not relevant for purposes of ascertaining liability for an alleged nonpayment of wages that did not occur until after the company was ordered into Chapter 7 bankruptcy. At that point, Kingen and Switzer were not officers of an operating business entity--much less an "employer."

With Funsters' entry into Chapter 7, a fundamental change occurred in the legal relationship between the company and its employees. *As a matter of law*, the Trustee succeeded to the status of "employer" and assumed all of the duties (including the duty to pay wages and employment taxes) that would otherwise have been the responsibility of the corporation and its agents. The Trustee similarly assumed all of the liabilities that would have devolved upon the corporation's officers had they remained in control. *United States v. Fogarty*, 164 F.2d 26, 30 (8th Cir. 1947).

It is no accident that this analysis tracks very closely Appellants' argument that Kingen's and Switzer's lack of control and authority over the organization after April 7, 2003 precluded a finding of willful and intentional

conduct on their part. The fact that these two arguments run hand in hand simply reinforces the conclusion that the elements of willfulness and intentionality cannot logically be found--or even reasonably *imputed*--to an actor who is no longer in any position to control (and in fact had nothing to say about) the decision that ultimately resulted in the nonpayment of wages.⁹ Because the Chapter 7 Trustee actually assumed the duties and liabilities of the "employer," and because the decision to forgo payment of the employees was made solely by the Bankruptcy Court only after that transition had occurred, Kingen and Switzer were not among the individuals that even *could* be held liable under the terms of RCW 49.52.050 and .070.

4. Even Apart from the Strictly Legal Question of Control and Authority, the Evidence Was Insufficient to Support a Finding of Willful and Intentional Conduct; To the Extent that Appellants Could Be Regarded as Having Exercised Control Over the Conditions That Ultimately Led to Funsters' Bankruptcy, the Evidence Could At Most Have Given Rise to an Issue of Material Fact.

The trial court's order granting summary judgment in favor of the respondent employees was predicated entirely upon its view that given the Washington Supreme Court's decision in *Schilling*, it had no choice but to impute to the appellants the mental state necessary to render them personally liable under RCW 49.52.070.¹⁰ (CP 1577-62, 1639-54.) In so doing, the

⁹ Even under Respondents' view of the case, any debate over Funsters' status as an "employer" would inevitably give rise to a bona fide dispute over the employer's obligation for wages. We need not go that far, however, because it is clear that neither Kingen nor Switzer had the status or the requisite intent to render them liable under RCW 49.52.050 and .070.

¹⁰ In fact, the trial court specifically concluded that the test under *Schilling* is *not* one of whether "I intend not to pay you." (CP 1640.)

court specifically declined to make a factual finding that Kingen or Switzer had engaged in willful and intentional conduct. To the contrary, it made clear that its ruling was based upon the assumption that Kingen and Switzer *did not* have any “personal” or “subjective” intent to deprive Funsters’ employees of wages. (CP 1651.) That premise was correct. Even a cursory review of the evidence reveals that the respondents were at a loss to come forward with even that amount of evidence necessary to make out a *prima facie* case of willful and intentional conduct.

The evidence adduced in connection with the summary judgment motion established quite clearly--even poignantly--that despite the seriously and persistently troubled condition of the business and the constant clamoring of creditors, payroll was always given “top priority.” (CP 369-70, 372, 381, 472-73, 480.) Of the considerable volume of evidence adduced by Appellants on this point, the most salient fact speaks for itself: During the entire period of time that Kingen and Switzer remained in control of the business--including the entire period of time it was operating as a Chapter 11 debtor in possession--there never was a time that the employees’ wages were not fully paid. (CP 448, 473-74, 480, 1642.) This is a fairly extraordinary circumstance in view of the crushing burden imposed by the company’s competing obligations and the fact that the owners were personally on the hook for the vast majority of the company’s debt. It is noteworthy that a number of other pressing obligations of the business--including federal and state tax obligations for which Kingen and Switzer stood to be personally liable--went unpaid so that payroll could, and would, be met.

For all the unjustified criticism the employees and their counsel have heaped upon these "wealthy men" for their capitalist ways, not once have they been able to point to an instance in which Kingen and Switzer were motivated by anything other than a sincere and honest desire to save the business--for the benefit of everyone concerned. Never once has it been alleged that they caused payroll funds to be diverted to more important or emergent uses. Never once has it been alleged that they dipped into company funds to line their own pockets. The opposite was true: It is uncontested that during the entire two-year lifespan of the business, neither Kingen nor Switzer took a dime in compensation for their nearly full-time efforts. (CP 359, 396, 475, 493.) Neither of them ever received a dime of return on the substantial monies they put into the venture.

Even after Kingen and Switzer had been stripped of all control and authority over the conduct of the business and all hope of recovering their investment was gone, they went out of their way to advocate on behalf of the employees--first, by lobbying the Trustee to keep the business running a while longer as an "operating Chapter 7," and, when that failed, by initiating a motion advocating that the cash assets of the estate be used first to pay the wages owed to Funsters' employees. (CP 316-19, 337, 366, 372, 391, 395, 423, 450, 469, 474.) Kingen and Switzer went so far as to urge that their own "superpriority" claims for debtor-in-possession financing be subordinated to those of the employees in order to achieve that result. (CP 316-19, 372, 391, 469, 474.)

Confirming the complete and total absence of evidence to support the charge that Kingen or Switzer wilfully and intentionally withheld wages from Funsters' employees was the deposition testimony of the three plaintiff class representatives. Although they were asked repeatedly what evidence they had to substantiate their claim that Kingen and Switzer had taken willful and intentional action to deprive them of wages, not a one of them was able to articulate--even generally--facts that would begin to support that position.

The following excerpt from the deposition of class representative (and former floor supervisor) Emma Morgan is illustrative:

Q: [BY MR. McINERNEY] Did Mr. Kingen intentionally not pay you?

A: What do you mean "intentionally?" Yes, he--probably if it is because he didn't pay us when the casino closed down. [Sic]

Q: Do you know what "intentionally" means?

A: Yes. "Intentionally" is not getting paid. We could have paid right now instead of filing this lawsuit. [Sic]

Q: Do you believe that Mr. Kingen made the decision not to pay you? The decision not to pay you? Not the decision to close the casino but the decision not to pay you?

A: I cannot answer you that.

Q: Do you have any evidence whatsoever that Mr. Kingen made the decision not to pay you; any evidence whatsoever?

A: He just didn't have--that's why we had that class-action lawsuit.

Q: I know you've got your lawsuit, but is there any evidence you have that Mr. Kingen intentionally did

not pay you?

A: Probably he does because he didn't pay us.

Q: What is the evidence that you have that he intentionally did not pay you? What is the evidence?

A: The evidence is by not paying us until now. It's almost a year now that we don't get paid.

Q: What other evidence do you have other than what you said that he intentionally did not pay you?

A: I don't know. I cannot say.

Q: Did Mr. Switzer intentionally not pay you your wages? Did he make the decision not to pay you?

A: I don't know.

(CP 409-10.)¹¹

Class representative Daniel McGillivray similarly testified that he had "no idea" whether the defendants had done anything intentional to cause him not to be paid. He conceded that the only evidence he had of such an intention was the fact that "I don't have a paycheck." (CP 426-28.) The same insubstantial answer was echoed by class representative Nancy Pitchford, who testified that the only evidence that Kingen and Switzer had intentionally deprived her of wages was the fact that "if he intended to pay the wages, he would have paid them." (CP 436-37.)

Only later did the respondents come up with the argument that Kingen and Switzer might have managed the business more adeptly, thereby avoiding

¹¹ Immediately upon returning from a recess with counsel, Ms. Morgan suddenly "remembered" why she believed that Kingen and Switzer had acted intentionally and asked to supplement her previous answers by stating that Kingen and Switzer were "officers" of Funsters. (CP 411-12.)

the necessity of bankruptcy, or that they could have strategically timed a voluntary Chapter 7 filing so as to assure that the employees were paid up to date before the liquidation occurred. With respect to the latter contention, which appears to suggest that Kingen and Switzer could have manipulated matters behind the Bankruptcy Court's back so as to give the employees preference over other Chapter 11 administrative creditors, we have only this to say: While Kingen and Switzer were 100 percent invested in assuring that Funsters' employees were fully paid, they were not prepared to defraud the Bankruptcy Court in order to do it.¹²

With respect to the employees' contention that Funsters' bankruptcy could have been avoided had the business been better managed, that contention was never supported by any actual evidence--much less by the kind of expert testimony that would have been required to substantiate such a claim. It was not enough for Respondents' counsel to simply intone, over and over again, that a business does not end up in bankruptcy unless somebody has done something wrong. Even if the respondent employees *had* offered competent expert testimony to the effect that Funsters' bankruptcy could more likely than not have been avoided, it ultimately would have been up to the finder of fact to determine whether that was, or was not, the case. Furthermore, the employees would still face the hurdle of proving that the appellants' conduct of the business was so clearly calculated to result in the

¹² The Bankruptcy Court noted that the employees' wage claims had the status of Chapter 11 "administrative expenses" and as such could not be paid ahead of other administrative claims. The court intimated that if the employees *had* been paid up to date as a result of a fortuity in timing, the Trustee would have been authorized to go back and recover those funds and to make a pro rata distribution. (CP 345.)

nonpayment of wages as to constitute "willful" and "intentional" conduct under RCW 49.52.050. Again that would have been a question of fact to be resolved at trial.

Similarly, the employees' argument that Funsters' managers had the option of shutting the business down sooner goes nowhere. There was absolutely no evidence--expert or otherwise--to suggest that Funsters' employees would have fared any better had the company ceased doing business at an earlier point in time. The uncontroverted evidence established that Funsters was in serious financial straits from the moment "9/11" occurred, and that for the next two years it was engaged in a continuous and unremitting struggle for survival. That Funsters' employees were owed hardly more than a pay period of wages when the business finally closed its doors is fairly remarkable in the world of Chapter 7 bankruptcy proceedings. The debate, however, is really quite beside the point, because (1) the respondent employees never did offer any competent expert evidence suggesting that the ultimate outcome for the employees could have been avoided, and (2) even if they had, the most that such evidence could have done was to create a genuine issue of fact.

Finally, the employees argue that Kingen and Switzer acted both "wilfully" and with the "intent to deprive" Funsters' employees of wages when they failed to gratuitously pay the employees' final wages out of their own pockets. This is a specious, and entirely circular, argument because Kingen and Switzer never had any personal obligation for those wages other than that which might arise as a result of being held liable under RCW

49.52.070. Obviously, if an officer or agent's failure to *voluntarily* cover the wage obligations of an corporate employer were enough to render him personally liable for those wages, there could never be a situation in which personal liability would not attach. RCW 49.52.070 would be entirely meaningless, and officers and agents of a corporation would be sureties of their corporations' wage obligations--pure and simple.¹³

In sum, it is clear that in order for personal liability to attach under RCW 49.52.050 and .070, the statutes require an affirmative finding that the nonpayment of wages resulted from "willful" conduct on the part of an officer or agent that was specifically "intended to deprive" employees of wages. Here, the respondent employees failed to establish, even *prima facie*, the existence of either of those elements. Accordingly, it was error for the trial court to have granted summary judgment in favor of the respondent employees, and to deny Appellants' counter-motion for summary judgment.

B. Respondents Were Not Entitled to Recover Damages in the Form of Federal Withholding Taxes For Which Appellants Remain Potentially Liable and for Which The Employees Have Received the Full and Intended Benefit.

In determining the amount of the unpaid "wages" due the respondent employees, the trial court included in its computation not only the amount of net wages due the employees, but an additional amount representing

¹³ Furthermore, federal law provides that when personal funds are used to pay corporate obligations, they become corporate funds. In the context of a bankruptcy, therefore, such payments would constitute an unlawful preference if not made strictly in accordance with the Bankruptcy Court's scheme of distribution. *See Sorenson v. United States*, 521 F.2d 325, 327 (9th Cir. 1975.)

employment withholding taxes (federal income tax, Social Security, and Medicare) that an employer is required by law to withhold from an employee's paycheck and to remit directly to the federal government. The court then *doubled* that amount pursuant to the penalty provision of RCW 49.52.070 to arrive at the total amount of damages awarded. (CP 1564-65.) The result of the trial court's decision to include withholding taxes in its computation of damages was both logically flawed and flagrantly inequitable inasmuch as the appellant officers remain potentially liable for the payment of those taxes, and inasmuch as the employees will, as a matter of law, receive the full and intended benefit of the withholding. (CP 729-737.)

In the proceeding below, the respondent employees argued that they should recover the gross, rather than net, amount of their wages because it was *they* who would ultimately be liable for the payment of income taxes on the amount of their recovery. The employees offered no authority for that purely off-the-cuff assertion, stating only that "This is a matter for Plaintiffs' tax advisors." (CP 705.) In actuality, Respondents do not, and cannot, have any liability for the employment taxes at issue.

Federal law speaks quite clearly to the issue of liability for employment taxes. Under 26 U.S.C. §§ 3102 and 3402, employers are required by law to withhold from their employees' wages both federal income taxes and mandatory contributions to Social Security and Medicare. Section 7501 of the Internal Revenue Code requires that these funds be held by the employer in trust for the government and remitted to the United States

Treasury on a quarterly basis.¹⁴ 26 U.S.C. § 7501(a); *Slodov v. United States*, 436 U.S. 238, 243, 98 S.Ct. 1778, 56 L.Ed.2d 251 (1978).

From the moment an employee receives wages, the withholding of employment taxes is deemed to have occurred, and all liability for the payment of those taxes shifts to the employer. *Begier v. IRS*, 496 U.S. 53, 110 S.Ct. 2258, 2260 (1990); 67 Fed. Reg. 65620 (2002); 26 U.S.C. § 3401. This is true regardless of whether the taxes have actually been withheld. *Id.*

The shifting of liability under the federal statutory scheme is complete. *When wages are paid to an employee, the amount of withholding taxes due on those wages is credited to the employee regardless of whether the employer ever actually remits those taxes to the Internal Revenue Service. In the event that the taxes are not paid, the government has recourse only against the employer.* See *Slodov*, 43 U.S. at 243; *Crutcher*, 89 A.F.T.R. at 4; *In re Sanderson*, - B.R. -, 87 A.F.T.R. 2002-770 (E.D.N.C. 2000) at *2; *Kelver v. United States*, 984 F. Supp. 1352, 1355 (D. Colo. 1997); *In re Thomas*, 222 B.R. 742, 748 (E.D. Va. 1998); *Cash v. United States*, 961 F.2d 562, 565 (5th Cir. 1992); *In re Rutherford*, 178 B.R. 716, 719 (S.D. Ohio 1995); *Finley v. United States*, 82 F.3d 966, 970 (10th Cir. 1996); *Donelan Phelps & Co., Inc. v. United States*, 876 F.2d 1373, 1375 (8th Cir. 1989); *In re Ribs-R-Us, Inc.*, 828 F.2d 199, 200 (3d Cir. 1987); *The Purdy Company of Illinois v. United States*, 814 F.2d 1183, 1186 (7th Cir. 1989).

¹⁴ There is no requirement that the withheld funds be deposited in a separate bank account or otherwise segregated from the employer's general funds until they are required to be paid to the Treasury. *Slodov*, 436 U.S. at 243; *Crutcher v. United States*, - F. Supp. 2d -, 89 A.F.T.R.2d 2002-1893, 2002 WL 509697 (N.D. Ala., 2002).

In the present case, both Kingen and Switzer were individually assessed by the Internal Revenue Service for the outstanding employment tax liabilities of Funsters. (CP 730.) They remain potentially liable, as "responsible persons" under 26 U.S.C. § 6672, for the additional employment taxes due on the wages which are the subject of this action.¹⁵ (CP 293.) By way of contrast, the respondent employees have no liability whatsoever for the employment taxes at issue, and in fact will receive full credit for them at the moment the wages are paid. In fact, the employees have *already* received a credit for those employment taxes which relate to the March 28, 2003 (second-to-last) payroll. Those taxes were among the "administrative expenses" claimed by (and presumably paid to) the IRS in Funsters' Chapter 7 bankruptcy proceeding.¹⁶ (CP 268.) *See Bellus*, 125 F.3d 821, 823-24 (9th Cir. 1997) (holding that employment taxes incurred during the course of a Chapter 11 proceeding, as well as penalties and interest associated with them, are to be paid from the bankruptcy estate as administrative expenses.)

In the present case, there is a distorted logic to the idea that Respondents should recover an amount of compensation to which they would not have been entitled had they received their wages in the form of a

¹⁵ 26 U.S.C. § 6672 allows the Internal Revenue Service to collect a statutory penalty equivalent to the amount of wages required to be remitted by an employer from any individual deemed to be a "responsible person."

¹⁶ Under federal law, the mere writing of the March 28, 2003 payroll checks was sufficient to cause the "withholding" of employment taxes to occur. *See In re Sunrise Paving, Inc.* 204 B.R. 691, 695 (D.Md. 1996) (noting that the mere writing of a payroll check that is not actually paid until some time later is sufficient to "identif[y] the property of the trust, so that it becomes the property of the IRS").

paycheck, as opposed to a judgment. Inasmuch as the purpose of an award of unpaid wages is compensatory, an award that allows a plaintiff to recover more than he would have received absent the defendant's alleged withholding of wages amounts to an unjustified windfall. See *Roselli v. Hellenic Lines, Ltd.*, 524 F. Supp. 2 D.C.N.Y. 1980) (denying compensation for fringe benefit payments made directly to retirement trust fund on ground that the plaintiff would not have received those payments had he continued working).

Here, the paradoxical effect of the trial court's judgment was to allow the employees to recover the amount of employment taxes payable on their wages *three times over*. First they were awarded the amount of those taxes in the form of compensatory damages. They then received that same amount again in the form of a punitive award. Finally, they received a credit with the IRS equivalent to the amount of those taxes. The flip side of that bonanza was that Appellants were held liable three times for the same employment taxes--taxes to which the employees were never entitled to begin with.

In sum, there is no theory of damages that entitled the respondent employees to be compensated (much less three times) for the loss of employment withholding taxes that they have no right to receive and that they would not have received had their wages been paid in the ordinary course. This is especially true in view of the fact that the employees have received the full and intended benefit of the amounts at issue in the form of a credit with the Internal Revenue Service. Finally, the fact that Appellants remain potentially liable for the payment of the employment taxes at issue, and that the employees *cannot possibly* be held liable for them, highlights the inequity

of treating the amount of those taxes as "damages." There is only one obligation, and it cannot be owed to both the employees and the IRS at once. Accordingly, we submit that the trial court erred by including in its judgment not only the net wages due the employees, but an additional amount representing employment taxes.

VI. CONCLUSION

Based upon the foregoing, Appellants respectfully urge that the Court of Appeals reverse the trial court's judgment and direct the entry of summary judgment in Appellant's favor.

Respectfully submitted this 17 day of October, 2006.



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STATE OF WASHINGTON
THE COURT OF APPEALS
DIVISION ONE

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STATE OF WASHINGTON
2006 OCT 17 PM 3:57

GERALD KINGEN and JANE DOE
KINGEN, husband and wife, and the
marital community comprised thereof;
SCOTT and JANE DOE SWITZER,
husband and wife, and the marital
community composed thereof,

NO. 57938-0-I

CERTIFICATE OF
SERVICE

Appellants,

v.

EUFEMIA "EMMA" MORGAN,
NANCY PITCHFORD, and DANIEL
McGILLIVRAY, individually and on
behalf of all the members of the class
of persons similarly situated,

Respondent

I certify under penalty of perjury under the laws of the State of
Washington that on the 17th day of October, 2006, true and correct
copies of the following documents:

1. Appellants' Brief
2. Certificate of Service

were served on the persons hereinafter named via Legal Messenger:

CERTIFICATE OF SERVICE - 1

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Briana Content, Legal Assistant