

No. 74808-4

COURT OF APPEALS FOR THE STATE OF WASHINGTON,  
DIVISION I

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PHILIP HOLROYD, an individual; and on behalf of BRET'S  
INDEPENDENT, LLC, a limited liability company,

Appellants,

v.

BRET HARTMAN, an individual,

Respondent.

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Division I  
State of Washington

REPLY BRIEF OF APPELLANTS

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## I. INTRODUCTION

Respondent's arguments supporting the trial court's summary judgment dismissal of Appellant's breach of contract, breach of fiduciary duty, and contract claims establish why this case between two LLC managers should proceed to trial.

The fact-finder should first determine whether Harman breached his fiduciary duty to the LLC and Holroyd. Interestingly, Hartman does not deny his questionable actions. Hartman unilaterally caused the LLC to pay Hartman \$263,880.00 in payments when the LLC was insolvent. Holroyd received nothing. Once the LLC's debtors came calling, Hartman transferred the LLC's assets to Hartman's personal corporation without consideration. This transfer of assets included the LLC's client lists and goodwill. Hartman's new corporation continues to operate and derive profit from the LLC's assets without compensation to either the LLC or Holroyd.

At its essence, Hartman argues that as a co-manager of Bret's Independent, LLC, Hartman had unfettered authority to do and act on behalf of the LLC regardless of his duty to co-manager, Holroyd, or his duty to the LLC.

The fact-finder should also determine whether Hartman breached the LLC's operating agreement. Hartman's claim that there is no LLC agreement, for summary judgment purposes, is unavailing. Hartman argues that this Court must disregard the terms of the LLC's operating agreement – an agreement Hartman testified was valid, and a contract Hartman introduced as evidence to support his summary judgment motion – only because Holroyd claimed that version was a forgery. In other words, Hartman asks this Court to ignore evidence before the trial court because the existence of a written LLC agreement creates issues of fact that should be resolved before the fact-finder.

Holroyd respectfully requests that this Court remand the matter back to the trial court so these issues of fact may be resolved.

## II. AUTHORITY

### A. Hartman Misstates How This Court Reviews Orders Granting Summary Judgment.

Throughout his response, Hartman misstates the inferences this Court should make for CR 56 purposes. In summary judgment proceedings, “the facts and reasonable inferences from the facts are considered in the light most favorable to the nonmoving party.” Robb v. City of Seattle, 176 Wn.2d 427, 432–33, 295 P.3d 212 (2013). Questions of law, on the other hand, are reviewed *de novo*. Id.

This Court may affirm or reverse the trial court on any basis supported by the record. Swinehart v. City of Spokane, 145 Wn. App. 836, 187 P.3d 345 (2008); LaMon v. Butler, 112 Wn.2d 193, 209-210, 770 P.2d 1027 (1989) (The Court of Appeals may support or overturn the trial court “upon any theory established by the pleadings and supported by the proof, even if the trial court did not consider it.”)

Hartman suggests this Court should review the facts only as Holroyd presented them, and draw the same inferences that Holroyd argued to the trial court, regardless of whether such positions are favorable to Holroyd, whether the record supports Holroyd’s position, or most importantly, whether Hartman introduced documentary evidence that contradicted Holroyd’s assertions.

**B. There is a Material Issue of Fact Whether the Parties Entered into an Enforceable Contract.**

When different inferences may be drawn from evidentiary facts, summary judgment is not warranted. Weisert v. Univ. Hosp., 44 Wn. App. 167, 172, 721 P.2d 553 (1986). Further, if the parties’ affidavits and counter-affidavits conflict on material facts, the court is essentially presented with an issue of credibility, and summary judgment should be denied. Riley v. Andres, 107 Wn. App. 391, 397-98, 27 P.3d 618 (2001).

Holroyd and Hartman’s declarations and deposition testimony conflict as to whether the two were operating under an enforceable LLC agreement. The conflicting declarations and questions concerning the existence of a contract create an issue of material fact. “[W]hether there has been mutual assent to the terms of a contract is a question of fact.” Ford v. Trendwest Resorts, Inc., 146 Wn.2d 146, 162, 43 P.3d 1223 (2002); Sea–Van Invs. Assocs. v. Hamilton, 125 Wn.2d 120, 126, 881 P.2d 1035 (1994).

Hartman’s appellate argument that there is no enforceable LLC agreement contradicts Hartman’s position in the trial court action. Hartman introduced the “Operating Agreement for Bret’s Independent, LLC” (the “LLC Agreement”) (CP 120-21) in Hartman’s December 24, 2013 motion for summary judgment. CP 206. Hartman testifies that the LLC Agreement was the only written agreement governing the two member/managers:

True and correct copies of the Certificate of Formation filed with the Washington Secretary of State on February 15, 1996, and the agreement related to the business, are attached to my motion for summary judgment of dismissal of Mr. Holroyd’s claims as Exhibit 2. Other than the duties detailed in the agreement, our duties as members of Bret’s Independent, LLC were not defined.

CP 206 at ¶3.<sup>1</sup>

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<sup>1</sup> Exhibit 2 is the LLC Agreement referenced by Holroyd in his Appellant’s brief. App. Br. at 19-20; CP 120-21.

After Holroyd claimed Hartman forged Holroyd's signature as on the LLC Agreement, Hartman still maintained that the LLC Agreement was the agreed-upon contract for Bret's Independent, LLC. In fact, Hartman testified during his deposition that he drafted the LLC Agreement and that it was effective as of the date it was signed. CP 334.

**1. This Court Makes All Reasonable Inferences in Favor of the Nonmoving Party. It Does Not Accept Every Statement as Fact Regardless of the Evidence Produced.**

As stated above, Hartman argues this Court must accept Holroyd's trial court position that Hartman forged Holroyd's signature on the LLC Agreement and therefore, there is no written LLC Agreement. Hartman then uses the claimed forgery as a sword, arguing that Holroyd's breach of contract claims fail because there is no binding written LLC agreement, **even though Hartman testified that the "Operating Agreement for Bret's Independent LLC" is the LLC's written operating agreement.**<sup>2</sup>

Of course, this Court is not bound by a party's argument as to the evidence; instead, this Court reviews the evidence and makes its own reasonable inferences in favor of the nonmoving party. Here, there is a written LLC Agreement, the existence of which supports Holroyd's

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<sup>2</sup> Hartman's argument is steeped in hypocrisy. Hartman claims that a "party cannot create a question on which reasonable minds could differ by contradicting his own evidence in the record and altering his position about whether there was a written operating agreement....In essence, Holroyd seeks to retract his sworn statement." Resp. Br. at 9.

*breach of contract* claim. Whether or not Holroyd alleges Hartman forged Holroyd's signature is immaterial. This Court must view this evidence in the light most favorable to Holroyd and the existence of the LLC Agreement creates an issue of material fact.

Second, Hartman suggests "for the purposes of the [summary judgment] motion," Hartman would agree no written contract exists and therefore, "there is no agreed written contract against which this Court can consider Holroyd's claim that Hartman breached a contract." Resp. Br. at 9. In other words, Hartman tells this Court to disregard the LLC Agreement, a written contract Hartman presented as evidence in his summary judgment motion. This turns the appellate court's review function on its head.

This Court should review all evidence before the trial court. It cannot ignore the existence of evidence just because one party suggests it should. Rather, this court should consider the signed LLC Agreement and determine whether that contract creates an issue of fact.

Ultimately, Hartman's position demonstrates a complete lack of candor before the court. Hartman twice testified – in deposition and by declaration – that the LLC Agreement (CP 120 - 21) was a binding LLC agreement for Bret's Independent, LLC. If there is no written LLC agreement, as Hartman now argues, then Hartman must also admit he

forged the LLC Agreement. Worse, Hartman must also admit that he offered the “forged” LLC Agreement into evidence and claimed it was a valid contract that bound both parties.

If the LLC Agreement is not a forgery, however, then Hartman seeks a truly Machiavellian solution. Hartman asks this Court to ignore the existence of the LLC Agreement – a written contract Hartman twice testified was valid - just so this Court will uphold the trial court’s dismissal of Holroyd’s breach of contract claims.

Significantly, Hartman never denies that the LLC Agreement exists, nor does he deny he introduced the LLC Agreement into evidence. Although the LCC Agreement is minimal and in some ways nonsensical, the LLC Agreement is clear that distributions should be 50/50, and that all financial arrangements require the signature of both parties. Issues of fact exist regarding whether Hartman breached the LLC Agreement.

## **2. The Fact-Finder Should Determine Whether Hartman Breached the LLC Agreement.**

In contract interpretation cases, if (1) the interpretation depends on the use of extrinsic evidence or (2) more than one reasonable inference can be drawn from the extrinsic evidence, summary judgment should be denied. Kries v. WA-SPOK Primary Care, LLC, 190 Wn. App. 98, 120, 362 P.3d 974 (2015). Contract interpretation is only a matter of law when

the interpretation does not depend on extrinsic evidence, or the extrinsic evidence permits only one reasonable interpretation. Marshall v. Thurston Cty., 165 Wn. App. 346, 351, 267 P.3d 491 (2011). Summary judgment should not be granted, however, when a contract is ambiguous. Id.

Here, the LLC Agreement provides that:

1. ALLOCTIONS [sic]. Net profits, losses, gains, deductions and credits from operations and financing shall be distributed among the Partners at a 50/50% basis.
2. DISTRIBUTIONS. The General Partner may make distributions annually or more frequently If there is excess cash on hand after providing for appropriate expenses and liabilities. Such interim distributions are allocated to each Partner according to the percentage of Partnership. (50/50%)...

**Financial agreements shall require the agreement and signatures of both Partners.**

CP 120-21 (emphasis added). The intent of the parties here is unclear. “Alloctions” is not defined. “Distributions” is not defined. “Financial agreements” is not defined.

Because the terms of the LLC Agreement are unclear, the manager’s rights and responsibilities are not defined, and the member’s rights are not detailed, the matter should be remanded back to the trial court to determine the intent of the parties when the contract was signed.

If this Court can decipher the LLC Agreement, it appears Hartman breached its terms. Although Hartman states Holroyd agreed Hartman could pay himself anything he wanted, there is no evidence before the Court that Hartman and Holroyd agreed to any kind of financial arrangement. Holroyd certainly did not agree or approve of Hartman making nearly \$265,000.00 in payments to himself to the detriment of Holroyd and the LLC.

The trial court should not have granted Hartman's summary judgment motion on the breach of contract action when Hartman does not dispute that:

- From 2008 – 2011, and without agreement from Holroyd, Hartman paid himself \$263,288.00. Holroyd received nothing. CP 834-37.
- In 2011, and without agreement from Holroyd, Hartman caused the LLC to distribute \$27,232.00 to Hartman. Holroyd received nothing. CP 867.

**C. The Derivative Action was not Dismissed.**

Hartman does not address the merits of Holroyd's derivative action. Instead, Hartman seeks to affirm the dismissal of the derivative claims on purported procedural deficiencies. First, Hartman argues Holroyd voluntarily dismissed the derivative cause of action, something the record does not support. Not only did the parties not dismiss the

action, Hartman and Holroyd continued to litigate the derivative claims up to and through the summary judgment hearing.

Second, Hartman claims Holroyd could not pursue a derivative action because Holroyd's complaint did not "set forth with particularity the effort" to cause the managers or members with authority to bring the action. Holroyd did not need to ask Hartman to bring a derivative action against himself on behalf of the LLC as doing so would have been futile.

**1. The Record Shows the Parties Continued to Litigate the Derivative Action. No Claim was Voluntarily Dismissed.**

Washington courts should not resort to dismissal lightly. Apostolis v. City of Seattle, 101 Wn. App. 300, 305, 3 P.3d 198 (2000).

The parties' actions and trial court's order on summary judgment do not support Hartman's argument that Holroyd dismissed his derivative action. In Hartman's first motion for summary judgment – the same motion that Hartman introduced the LLC Agreement – Holroyd did agree to dismiss his derivative claim. CP 225. However, no dismissal was entered, and the record does not indicate why the parties chose not to dismiss the derivative action prior to the summary judgment hearing.

The record does show, however, that Hartman continued to argue for summary judgment dismissal in his summary judgment reply. CP 505. Had Holroyd truly dismissed the derivative cause of action, there would be

no reason for Hartman to continue arguing the issue. Instead, Hartman devoted an entire section to the derivative claims in his January 17, 2014, reply brief arguing how Holroyd failed to reinstate the LLC and Holroyd's failure to reinstate "must bar him from maintaining any derivative action claim by the LLC against Hartman." CP 505. Hartman never claims Holroyd "dismissed" his derivative action in his reply brief. Instead, Hartman titles the section:

**Holroyd has failed to prove a derivative action claim against Hartman, and that claim must be dismissed.**

CP 505.

Further, in its summary judgment order, the trial court does not state that Holroyd dismissed his derivative action, nor does the record evidence such a dismissal. CP 510 – 13. Instead, the record indicates the parties argued the issue in the first summary judgment hearing, and the court decided the matter after hearing the parties' argument. *Id.*

Accordingly, this Court should review the summary judgment dismissal of the derivative action *de novo*.

**2. Holroyd is a Member and Manager of the LLC. He Did Not Need Additional Authority to Bring the Derivative Action.**

RCW 25.15.370 permits a member to bring an action on behalf of a limited liability company if the "managers or members with authority to

do so have refused” or “if an effort to cause those managers or members to bring the action is not likely to succeed.” RCW 25.15.380 further requires that “the complaint shall set forth with particularity the effort, if any, of the plaintiff to secure initiation of the action by a manager or member” or the reasons for not making the effort.

At the time Holroyd filed the derivative action, he was still a member and manager of the LLC. Hartman even states as much in his Reply in Support of Motion for Summary Judgment:

**It is undisputed that Holroyd was still an equal owner and manager of the business during the entire period of 4+ years he claimed to have been taking care of his mother.**

CP 1182 (emphasis added). As the parties do not dispute that Holroyd was a manager of the LLC, Holroyd could bring a derivative action.

Seeking Hartman’s authority to bring a derivative action against himself would have been futile.

### **3. Hartman Failed to Address the Merits of the Derivative Claim.**

Hartman never addresses the substance of the derivative claims Holroyd asserted on behalf of the LLC. Accordingly, it must be presumed that Hartman does not deny that the derivative suit was timely, and that the trial court improperly dismissed the derivative action on that ground. See Adams v. Dep’t of Labor & Indus., 128 Wn.2d 224, 229, 905 P.2d 1220

(1995) (this Court may decide this issue on the unchallenged argument and record before it.)

**D. As a Manager, Hartman Breached His Fiduciary Duty to Holroyd and the LLC.**

**1. LLC Managers Owe Fiduciary Duties to the Other Managers, Members, and the LLC.**

Hartman claims that as a matter of law, Hartman did not breach any fiduciary duty owing to Holroyd. Hartman claims that he could not be liable because “[a]s a manager...RCW 25.15.150(2)(a) 2012, which vests managers with decision-making powers,” permits his actions. Hartman’s argument that managers have *carte blanche* authority to act, provided such activity is not barred by the LLC’s operating agreement, conflicts with RCW 25.15.155 and well-established law on the matter.

The LLC statute clearly denotes when a member or manager may be liable to both the LLC and the other member(s) of the LLC:

Unless otherwise provided in the limited liability company agreement:

(2) Every member and manager must account to the limited liability company and hold as trustee for it any profit or benefit derived by him or her without the consent of a majority of the disinterested managers or members, or other persons participating in the management of the business or affairs of the limited liability company from (a) any transaction connected with the conduct or winding up of the limited liability company or (b) any use by him or her of its property, including, but not limited to, confidential or proprietary information of the limited

liability company or other matters entrusted to him or her as a result of his or her status as manager or member.

RCW 25.15.155 (2011).<sup>3</sup>

A claim for breach of fiduciary duty requires (1) the existence of a duty owed, (2) breach of that duty, (3) resulting injury, and (4) that the claimed breach proximately caused the injury. Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP, 110 Wn. App. 412, 433-34, 40 P.3d 1206 (2002).

“[O]nly those members serving as managers owe fiduciary duties.” Dragt v. Dragt/DeTray, LLC, 139 Wn. App. 560, 575, 161 P.3d 473 (2007).<sup>4</sup> Further, LLC managers are entitled to rely in good faith on other managers. Dickens v. All. Analytical Labs., LLC, 127 Wn. App. 433, 440, 111 P.3d 889 (2005) (citing the former RCW 25.15.175).

Here, Hartman first breached his fiduciary duty by unilaterally deciding to make \$263,288.00 in payments to himself from 2008 – 2011, the years he managed the LLC. During that same time frame, he paid Holroyd nothing. At a minimum, these payments were not discussed with, authorized by, or agreed to by Holroyd. Rather, these payments minimized distributions available for Holroyd.

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<sup>3</sup> Repealed by 2015 c 188 § 108.

<sup>4</sup> “An LLC is a creation of statute and not a creation of contract like a general partnership. Therefore, similar to shareholders in a corporation, members in an LLC do not have inherent fiduciary duties to one another. As long as members are not acting in a managerial capacity, they do not have fiduciary [duties] to one another unless such fiduciary duties are set forth in the operating agreement.” Id. at 574 (citation omitted).

**2. Hartman Breached His Fiduciary Duty By Paying Himself Over \$262,000.00 When the LLC was Insolvent.**

Further, Hartman does not deny that he paid himself and made distributions to himself when the LLC could not pay its debts and was insolvent. “[A] member may become liable to the LLC if the member receives a distribution from the LLC knowing that, after taking the distribution, the LLC would not be able to pay its usual debts or that the LLC's debts would exceed its assets. Humphrey Indus., Ltd. v. Clay St. Assocs., LLC, 176 Wn.2d 662, 674–75, 295 P.3d 231 (2013).

Hartman admits he made payments to himself ranging from \$42,000.00 to \$88,000.00 a year during a time when “Bret’s Independent was saddled with very significant debts to many creditors and the IRS.” CP 207. During the same years that Bret’s Independent began defaulting on its equipment lease payments (2008 and 2009), Hartman paid himself \$62,200.00 and \$70,579.00 in payments. CP 834-37. In 2011, when Hartman testified that “Bret’s Independent was undisputedly upside down in value,” (CP 207), Hartman distributed \$27,232.00 to himself and paid himself a \$42,322.00 payment. CP 867. Holroyd received nothing.

**3. Hartman Breached His Fiduciary Duty By Converting the LLC Assets.**

As Holroyd stated in his initial brief, “if a director or officer converts corporate property, she has breached that duty to operate in good faith.” Lang v. Hougan, 136 Wn. App. 708, 718, 150 P.3d 622 (2007).

Hartman does not deny that he transferred the assets of Bret’s Independent to his personal corporation. Hartman claims, without support other than his bare assertion, that “Bret’s Independent...[did not] own most of the non-fixture equipment located at the leased premises.” Resp. Br. at 3.<sup>5</sup> These statements have not been confirmed and should be before the fact-finder.

“[W]here material facts are particularly within the knowledge of the moving party, courts have been reluctant to grant summary judgment.” See Michigan Nat. Bank v. Olson, 44 Wn. App. 898, 905, 723 P.2d 438 (1986). In such cases, “it is advisable that the cause proceed to trial in order that the opponent may be allowed to disprove such facts by cross-examination and by the demeanor of the moving party while testifying.” Id.

Here, the full extent of the assets transferred to Hartman’s personal corporation, and the value of those assets, have not been disclosed.

Holroyd, on the other hand, testifies that the fair market value of the remaining equipment was in the tens of thousands of dollars. This does

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<sup>5</sup> Hartman cites to CP 586 – 87 which is the declaration of Lisa Holroyd. Holroyd is unclear how this cite supports the statement regarding Bret’s Independent.

not include the value of the LLC's goodwill and customer base. CP 236; CP 11016; CP 1018. This matter should be remanded to the trial court to allow the fact-finder an opportunity to determine the extent of the duty breached by Hartman, and damages Holroyd and Bret's Independent, LLC incurred as a result.

#### **4. Holroyd's Claims are Both Direct and Derivative.**

Hartman argues that his actions only harm the LLC, and therefore, the claims in this case are only derivative. This is not the case. Hartman's actions caused damage to both the LLC and to Holroyd, personally. The claims asserted here are both direct and derivative.

"A member may bring an action in the superior courts in the right of a limited liability company to recover a judgment in its favor." RCW 25.15.370. In contrast, a member may only bring a direct claim where the member suffered an injury separate and distinct from that suffered by other members. Sabey v. Howard Johnson & Co., 101 Wn. App. 575, 584 – 85, 5 P.3d 730 (2000).

This analysis is consistent with Delaware law, which Washington courts often reference because the Delaware courts have significant experience with the law of business entities. See, e.g. In re F5Networks, Inc., Derivative Litig., 166 Wn.2d 229, 239-40, 207 P.3d 433 (2009).

In Polak v. Kobayashi, CIV. 05-330-SLR, 2008 WL 4905519, the U.S. District Court of the District of Delaware addressed whether a claim is direct or derivative. In that case, the plaintiff and defendant formed an LLC to acquire and develop Hawaiian real estate. Id. at 2-3. Plaintiff and defendant were 50/50 members and managers. Id. The relationship soured and plaintiff and defendant did not speak for several years. Unbeknownst to plaintiff, defendant misappropriated one of the LLC's properties and purchased that property, individually. The defendant also instituted litigation on behalf of the LLC without plaintiff's authority or approval. Plaintiff ultimately filed suit seeking sale of the LLC properties and an accounting from defendant. Id. at 10-12.

The Kobayashi court first determined that the defendant had breached the LLC Agreement and breached his fiduciary duty. The issue, however, was determining what claims were held by the plaintiff, individually, and what claims were held by the LLC's.

The Kobayashi court stated: "Whether a claim is direct or derivative 'turns solely on who suffered the alleged harm and who would receive the benefit of any recovery or other remedy.'" Kobayashi, 2008 WL 4905519 at \*15. The court added that the plaintiff must demonstrate that a duty owed to him was breached, and that he can prevail without showing an injury to the LLC. Id. at \*16.

Accordingly, the Kobayashi court determined that the plaintiff's breach of contract claim was direct. Specifically, the court held that "**the breach of contract claim is based on defendant's unilateral decision-making for [the LLC], which impaired plaintiff's contractual right to jointly manage [the LLC].**" Id. at 17 (emphasis added). The breach of fiduciary duty claims, however, were derivative.

Here, Holroyd has alleged claims that are both direct and derivative. Holroyd's direct claims arise out of the breach of contract. Hartman made significant financial decisions without seeking Holroyd's approval. Hartman also deprived Holroyd of the right to jointly manage Bret's Independent.

The fact-finder must determine whether the remaining injuries are to both Holroyd and the LLC, or just the LLC. In either event, the matter should proceed to trial to determine the extent and amount of damages Holroyd and the LLC incurred.

**E. Both Holroyd and Bret's Independent, LLC were Damaged.**

The amount of damages is generally a question of fact. Mutual of Enumclaw Ins. Co. v. Gregg Roofing, Inc., 178 Wn. App. 702, 315 P.3d 1143 (2013). Although the precise amount of damages need not be shown with mathematical certainty, "competent evidence in the record" must support the claimed damages. Fed. Signal Corp. v. Safety Factors, Inc.,

125 Wn.2d 413, 443, 886 P.2d 172 (1994) (quoting Interlake Porsche & Audi, Inc. v. Bucholz, 45 Wn.App. 502, 510, 728 P.2d 597 (1986)).

There is sufficient evidence of damages before this Court. As stated numerous times, Hartman unilaterally decided to pay himself nearly \$265,000.00 when the LLC was either insolvent or was struggling to pay its debts. Hartman also transferred all of Bret's Independent's assets, including the customers and goodwill of the company, to Hartman's personal corporation. Neither the LLC nor Holroyd were compensated for this transfer. The value of these assets will be determined by the fact-finder, after hearing testimony from the parties and experts on the subject. There was no requirement that Holroyd, when defending a motion for summary judgment, present evidence of the precise amount of damages he incurred.

### **III. CONCLUSION**

This case should have proceeded to trial. Hartman's position – that a LLC manager has unfettered authority to act in his own self-interests – is not supported by law. Rather, Hartman's actions constitute a breach of the LLC Agreement and a breach of Hartman's fiduciary duty to his co-manager, Holroyd, and to the LLC. These issues should be resolved by the fact-finder.

DATED this 29<sup>th</sup> day of August, 2016.

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## PROOF OF SERVICE

Pursuant to the Rules of Appellate Procedure 18.5 and CR 5, I certify that on August 29<sup>th</sup>, 2016, I filed this brief with the clerk of the court for the United States Court of Appeals Division I by the CM/ECF system. I also certify under the penalty of perjury that I served the foregoing document via regular mail, self-addressed postage prepaid and electronic mail on the interested persons as identified below:

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