

NO. 35291-5-II

07.11.20 11:15

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

STATE OF WASHINGTON  
BY *[Signature]*  
DEPUTY

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ROBERT R. MITCHELL, LISA TALLMAN, MITCHELL FAMILY  
LIVING TRUST, GARY GREINDAHL, JOANN GREINDAHL,  
OLYMPIC CASCADE TIMBER, INC., a Washington Joint  
Venture Partnership, ROBERT R. MITCHELL, INC., a  
Washington Corporation; TIMOTHY JACOBSON, HILARY  
GRENVILLE,  
Appellants,

v.

MICHAEL A. PRICE and JANE DOE PRICE, husband and wife;  
THOMAS W. PRICE and JANE DOE PRICE, husband and wife;  
JAMES REID and SONJA REID, husband and wife; KEVIN M.  
BYRNE and MARY BYRNE, husband and wife; THOMAS H.  
OLDFIELD and JANE DOE OLDFIELD, husband and wife; NW,  
LLC a Washington Limited Liability Company,  
Respondents.

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**CONSOLIDATED REPLY BRIEF**

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Appellants file this Consolidated Reply Brief to the three respondents' briefs filed on behalf of the respondents.

Plaintiffs received notice that Michael Price has filed for chapter seven bankruptcy. Appeals are automatically stayed after bankruptcy of a party if the original proceeding was brought against him. *Ingersoll-Rand Financial Corp. v. Miller Mining Co.*, 817 F.2d 1424, 1426-27 (9th Cir. 1987). "Relief from an automatic stay is possible, however, under section 362(d). The bankruptcy court, under this section, may lift a stay upon request of a party in interest following notice and a hearing." *Id.* at 1427; 11 U.S.C. § 362(d). In any event, "[i]n the absence of special circumstances, stays pursuant to section 362(a) are limited to debtors and do not include non-bankrupt co-defendants." *Ingersoll-Rand Financial*, 817 F.2d at 1427.

Plaintiffs presume that the appeal as to all plaintiffs other than Michael Price is unaffected by the bankruptcy and submit this brief under that assumption.

### **REPLY TO COUNTERSTATEMENT OF FACTS**

The parties largely agree on the underlying facts of this case. Where the defendants disagree, they have often forgotten the standard of review on appeal of a summary judgment motion.

All facts and inferences must be viewed in the light most favorable to the plaintiffs. *Teller v. APM Pacific Term., Ltd.*, 134 Wn. App. 696, 704, 142 P.3d 179 (2006). Additionally, defendants have omitted critical sections of the documents on which they depend for evidence of the statute of limitations dates.

NW Commercial Loan Fund (“NW Commercial”) was managed by Byrne through his management of NW, LLC, Byrne and Reid Response Brief (“BRRB”) 5; CP 1335, with consultation from Reid, CP 361, and under their management, NW Commercial grossly violated the Private Placement Offering Memorandum.<sup>1</sup> Byrne and Reid argue that plaintiffs have not recognized the discretion granted to the General Manager of NW Commercial. BRRB 6. Plaintiffs acknowledged that discretion in opening, BA 5-6, and do again here, but also emphasize that the discretion of the General Manager is limited so that no more than 10% of the

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<sup>1</sup> Defendants argue that the private placement offering memorandum (“PPM”) did not apply while the company assets are less than \$5,000,000. BRRB 6. However, the cited PPM is dated July 1999. CP 375. The cover letter for the original PPM was dated June 1998. CP 373. Oldfield acknowledges that there were multiple versions of the PPM, but that the May 1998 version was the version circulated to prospective investors. CP 1554-55. This discrepancy is important only for the purposes as to the underlying merits of the case, not to this procedural appeal. The May 1998 version of the PPM will be presented to the trial court on remand.

company's assets may be invested in nonconforming mortgages. CP 384. Additionally, exceptions are to be made to the general investment guidelines "only in a limited number of instances." CP 383. In contrast, Byrne completely ignored the requirements set forth and committed 97% of the loan funds into a single project rather than creating a diversified portfolio and accepted loans that were subordinate to more senior mortgage liens. BA 8; CP 361-62, 661. Even allowing for discretion of the general manager, the defendants clearly violated the provisions on which NW Commercial was founded.

Oldfield argues that he was not aware of an investment strategy that would contradict the offering memorandum when he prepared that memorandum. ORB 9. Plaintiffs argue that Oldfield later learned the facts surrounding the violation of the offering memorandum and did not disclose this violation to NW Commercial members. BA 10; CP 1565. Even after learning about the violations of the offering memorandum, Oldfield did not disclose them to the members of NW Commercial, causing plaintiffs' fears to be allayed and causing plaintiffs to be further damaged. CP 1616-17. Additionally, Oldfield did not disclose his conflict of interest in simultaneously representing NW and NW Commercial. BA 10; CP

1568. More importantly, this appeal is not the proper forum to argue the merits of the underlying case. This appeal on a procedural summary judgment should be resolved and remanded for the trial court to decide the case on the merits of the claims.

The parties dispute the timeline of plaintiff's discovery of Byrne's torts and breaches of contract in 2001. These factual disputes should be decided in favor of the plaintiffs for the purposes of summary judgment. *Teller*, 134 Wn. App. at 704. The parties agree that Grendahl and accountant Stevens met with Byrne and Oldfield in March 2001 to discuss NW Commercial and a partial withdrawal of his investment from NW Commercial. BA 9; BRRB 8. Oldfield incorrectly states that Grendahl became aware of issues with the loans at that time. See ORB 4. To the contrary, the evidence cited by Oldfield shows that Byrne and Oldfield concealed the loans because of "privacy concerns" and assured Grendahl that all loans were secured by first position deeds of trust. BA 9; CP 1509, 1616-17.

Oldfield learned that NW had violated NW Commercial's offering memorandum, CP 1565, but he neither advised Byrne and Reid to disclose this violation to NW Commercial's members nor disclosed the violation himself. BA 9; CP 1565, 1568. Oldfield

represented both NW and NW Commercial without disclosing a potential conflict of interest. CP 1554. At the meeting, Oldfield gave the impression of representing NW Commercial by sitting across from Byrne and next to Grendahl. CP 1616. Byrne and Oldfield's misrepresentations prevented the plaintiffs from learning the facts of the underlying fraud early in 2001.

Defendants do not even agree when the plaintiffs learned the underlying facts of the fraud. Oldfield asserts that plaintiffs learned about NW Commercial's investment practices in March 2001. ORB 4. As described above and in plaintiffs' opening brief, BA 9-10, Byrne and Oldfield concealed the facts in March 2001, rather than disclosing them. Byrne and Reid assert that plaintiffs learned the details of the loan in May 2001. BRRB 8. Of course, the basis for this assertion is Byrne's statement, CP 1144, which is vehemently denied by the plaintiffs. CP 1357-58, 1620 ("Byrne's claims that he told me in May of 2001 that the NWCLF loans were in second position, that some loans were delinquent, and that NW, LLC owned 50% of the Graham square property is entirely false.") Again, on summary judgment, these discrepancies are resolved in favor of the nonmoving party.

All defendants point to the Woodell letter as the point when the plaintiffs had knowledge of the instant claims. ORB 4-5; BRRB 10-11; PRB 3. However, the defendants cut off their lengthy block quote one sentence before the critical section that refutes the theory that the Woodell letter shows the plaintiffs' knowledge about their claims:

We are so concerned that we do not yet have all the pertinent facts, we must demand that our accountant, William R. Stevens, be given immediate access to NW Commercial Loan Fund records to audit the status of the loan portfolios and bank accounts.

CP 1200. Plaintiffs explicitly acknowledged their ignorance of the facts surrounding the underlying claims within the Woodell letter itself. It is no surprise that Byrne and Reid omitted this section from their block quote of the letter. BRRB 10-11. Furthermore, Oldfield is wrong to state that the Woodell letter set forth the exact claims brought in this lawsuit. ORB 4. The Woodell letter contains no mention of any possible claims against Oldfield. CP 1199-201.

Defendants further rely on the Yanick memo as evidence to establish the date before which plaintiffs needed to bring this suit under the statute of limitations. BRRB 12-13, 32. The Yanick

memo is incompetent hearsay based on unknown facts<sup>2</sup> that reaches inconsistent conclusions. BA 16-18. Moreover, defendants again omit the critical portion of the document. After giving his opinion about the statute of limitations, Yanick admits confusion over the relevant dates.

We need to square these statements with the timing of events as described above. In general, the sequence of events will have to be clarified eventually. It would help to have someone review the file and make a detailed timeline.

CP 1236. Despite the plaintiffs quoting this section in their opening brief, defendants omitted it from their quotation rather than provide explanation why the statement does not further discredit Yanick's account of the timeline. BRRB 12-13.

The Prices do not even cite to the record in giving their account of the facts. PRB 2-7. Instead, aside from citing the pages of several procedural facts, the Prices only cite to the findings of fact and conclusions of law filed this May in conjunction with the attorney's fees award. *Id.* The plaintiffs will address these findings in their brief in the consolidated appeal from

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<sup>2</sup> Yanick was never called as a witness to explain how he reached his conclusion.

the findings and judgments.<sup>3</sup> Suffice it to say that this is a summary judgment appeal. The issue is not whether the court entered findings, or even whether evidence was presented that supports those findings. The issue is whether the evidence was disputed, and the Prices fail to acknowledge or address the factual disputes.

Aside from the assertions above about different points when the plaintiffs learned the underlying facts surrounding the fraud, the defendants have left the plaintiffs' account of the 2001 events largely undisputed. BA 8-18. Plaintiffs presented myriad evidence that the plaintiffs did not learn about the underlying facts until August 2001, CP 13-15, and did not suffer damage from the fraud until much later in 2001, CP 18. This evidence is ample to require trial.<sup>4</sup>

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<sup>3</sup> The findings of fact and conclusions of law were filed May 18, 2007 after the plaintiffs argued that the attorney's fees order was incomplete because it was not accompanied by findings of fact. BA 45-46. Because these findings were filed after the opening brief, plaintiffs will file a separate brief assigning and arguing error rather than improperly raising issues for the first time in reply.

<sup>4</sup> Defendants assert briefly that Loan Holdings, the company started by Byrne and Reid to manage NW Commercial after NW, was released with Byrne and Reid from liability for investments made between June and November 2001. BRRB 11. This release was conditioned on payment, which was never received. CP 482.

## ARGUMENT

**A. NW Commercial's claims against the defendants were validly assigned to the plaintiffs by a validly appointed manager.**

**1. Mitchell was validly appointed manager of NW Commercial.**

In arguing that Mitchell was not manager of NW Commercial at the time of his sale of the claims to the current plaintiffs, Byrne and Reid Response Brief ("BRRB") 13-14, defendants forget the standard of review for a summary judgment. The defendants must prove on summary judgment that no reasonable factfinder could disagree with the conclusion of the court. *Cotton v. Kronenberg*, 111 Wn. App. 258, 264, 44 P.3d 878 (2002); CR 56(c). Despite this standard, defendants do not reach one conclusion. See BRRB 13-14. Instead, Byrne and Reid argue through inferences only that the letter may have been backdated. *Id.* Firstly, all inferences go in favor of the nonmoving party for the purposes of a summary judgment. *Korslund v. DynCorp Tri-Cities Servs.*, 156 Wn.2d 168, 177, 125 P.3d 119 (2005). Secondly, a reasonable factfinder could reject the inference that the assignment was backdated.

Even Oldfield does not accept Byrne and Reid's inference and argues that it is unclear when the document was signed. Oldfield Response Brief ("ORB") 24-25. In fact, as plaintiffs argued

in opening, Oldfield has admitted that Mitchell was the manager of NW Commercial. RP 10. The Prices do not dispute that Mitchell was manager. Clearly, if the defendants themselves reach different conclusions, trial is required to decide whether to take the signed, dated document at face value.

**2. The assignment of claims was not a “distribution” to members.**

Defendants do not respond to plaintiffs’ argument that RCW 25.15.235 does not render an assignment void if violated because it only creates potential liability. BA 24. Following a theme throughout defendants’ briefs, defendants conflate potential liability with voidability of the assignment. See, e.g., ORB14. Even if NW Commercial did violate RCW 25.15.235, it would simply create liability for NW Commercial. It would not void the assignment. Defendants are not claiming damages from a breach of RCW 25.15.235; therefore, that statute is irrelevant to this appeal. The trial court erroneously conflated liability with voidability.

**3. The assignment did not violate bankruptcy laws.**

**a. Undisclosed claims revest after confirmation of the bankruptcy plan and the reorganized debtor may pursue these claims subject to the interests of creditors.**

**i. *Stein* was based on interpretation of the Bankruptcy Act of 1898, not the current Bankruptcy Code.**

Defendant Oldfield argues that assets not listed in the bankruptcy schedules do not vest in the reorganized debtor, citing ***Stein v. United Artists Corp.***, 691 F.2d 885 (9th Cir. 1982). ORB 17-18. Oldfield overlooks that ***Stein*** was expressly decided under the Bankruptcy Act of 1898, which was replaced in 1978 by the current Bankruptcy Code. ***Stein***, 691 F.2d at 888 n.1. The change in law is critical—the language upon which ***Stein*** relied is not present in the Bankruptcy Code and is replaced with language that reverses ***Stein's*** holding. Because ***Stein*** is expressly premised upon old, inapplicable law, it has no precedential value for this court.

**ii. The plain meaning of the Bankruptcy Code reverts the claims against all defendants in NW Commercial.**

The plain language of the Bankruptcy Code provides that all property of a reorganized debtor is revested in the debtor:

Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

11 U.S.C. § 1141(b). Congress has said that confirmation vests all property in the debtor. Not just disclosed property, not just some property—"all of the property." *Id.*

Oldfield relies on ***Stein***, which is based on the repealed Bankruptcy Code of 1898. The ***Stein*** court described the issue before it:

Century did not list the antitrust cause of action against appellees in the arrangement proceeding, and the claim was not brought to the attention of the bankruptcy court. Whether Stein can now proceed to enforce Century's anti-trust claim depends on whether the cause of action revested in the bankrupt, Century, despite its failure to list the asset. Former section 70(i) of the Bankruptcy Act, 11 U.S.C. § 110(i) (1976), provided that upon the confirmation of an arrangement or plan in bankruptcy, "the title to the property dealt with shall revert in the bankrupt or debtor." The dispute on appeal centers on whether the antitrust claim can be said to have been "dealt with" in bankruptcy.

691 F.2d at 889-90. The court concluded:

We hold that in Chapter XI proceedings, "property dealt with" refers to property administered or listed in the bankruptcy proceedings and supervised by the bankruptcy court, and therefore only such property reverts to the bankrupt upon termination of the bankruptcy proceedings.

*Id.* at 893.

***Stein***'s holding is no longer good law because Congress changed the old provision that "the title to the property dealt with"

reverts in the debtor to the current provision that “all of the property of the estate” vests in the debtor. “There was a material change from the predecessor provision that applied to chapter XI of the former Bankruptcy Act. [Under the Bankruptcy Act,] only ‘property dealt with’ in a plan or arrangement reverted.” *In re JZ, LLC*, \_\_\_ F.3d \_\_\_, 2007 Bankr. LEXIS 2293, \*14 (B.A.P. 9th Cir. 2007) (citing Bankruptcy Act § 70(i), 11 U.S.C. §110(i) (1976)).

*In re JZ, LLC*, expressly refutes defendants’ argument. “Diamond Z’s argument that JZ lacks standing because the unscheduled license is still property of the estate misconstrues the Bankruptcy Code, even if JZ unjustifiably omitted it.” *Id.* at \*10. “Section 1141(b) vests *all* of the property of the estate, scheduled and unscheduled, in the debtor upon plan confirmation, unless the court or plan provides otherwise.” *Id.* at \*11. Hence, it is decided law that “a reverted chapter 11 debtor,” as NW Commercial was here, “has standing to sue on causes of action that are property of the estate.” *Id.*

The language interpreted by the *Stein* court—“property dealt with”—was carried over into a different section of the 1978 Bankruptcy Act:

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the **property dealt with** by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

11 U.S.C. § 1141(c) (emphasis added). Interpreting subsection (c) in light of *Stein*, this language means that property disclosed or dealt with in the Chapter 11 proceedings emerges from reorganization “free and clear of all claims and interests” of the listed parties. *Id.* The negative implication of subsection (c) is that unlisted property, i.e., property not “dealt with”, remains subject to the claims and interests of the listed parties.

These two subsections of § 1141 work together and must be read together. Under subsection (b), “all property of the estate” vests in the reorganized debtor. But under subsection (c), if a revested property was never “dealt with” in the bankruptcy, the creditors, equity security holders, and general partners of the debtor may still have claims against the property.

This is an eminently sensible statutory scheme. The claims of NW Commercial must vest somewhere, and it makes sense to leave them with NW Commercial. To the extent that any of the defendants, such as Byrne, have any rights as creditors, equity

security holders, or general partners in NW Commercial, they might have a claim against any proceeds eventually resulting from prosecution of this lawsuit. But any possible interest does not make the claim or assignment void, as the defendants argue.

Oldfield confuses the effect of subsections (b) and (c), arguing that the language of subsection (c) means that unlisted assets “remain part of the bankruptcy estate.” ORB 17 (citing *Stein*). Oldfield ignores the fact that subsection (b) says exactly the opposite—all property vests in the reorganized debtor.

**iii. 11 U.S.C. § 1141(c) specifies a class to enforce improper disclosures. Defendants Oldfield, Reid, Price, and Price do not fall into that class.**

The plain language in § 1141(b) incorporates sound public policy. Oldfield cites *Stein* for the proposition that vesting property in the debtor may give the debtor incentive not to list property in bankruptcy. ORB 18 (*quoting Stein*, 691 F.2d at 892). These concerns are addressed by the new scheme under the Bankruptcy Code. Rather than disallowing revestment of undisclosed property, the Bankruptcy Code refuses bankruptcy protection to the undisclosed property so that the benefits of the claims go to the creditors, rather than the bankrupt. See 11 U.S.C. § 1141(c).

Allowing the creditors to potentially benefit from the assets by revesting the property is far more equitable than giving a windfall to fraudulent parties.

Section 1141(c) creates a class of parties who can enforce proper disclosure of assets by identifying parties who retain an interest if the property is not dealt with by the plan. Property not dealt with by the plan is subject to “claims and interests of creditors, equity security holders, and of general partners in the debtor.” 11 U.S.C. § 1141(c). Defendants Oldfield, Reid, Price, and Price certainly do not fall into this class of parties. Oldfield, Reid, Price, and Price did not have a real interest in the claims of NW Commercial. They were neither members nor creditors of NW Commercial and had no rights either to the claims themselves or to the value of the claims as property. Oldfield, Reid, Price, and Price did not directly benefit or suffer from the assignment of the claim.

Oldfield, Reid, Price, and Price would not even have standing to make their argument. “A person has standing to challenge a court order or other court action if his protectable interest is adversely affected thereby. The interest shown cannot be simply the abstract interest of the general public in having others comply with the law.” **Vovos v. Grant**, 87 Wn.2d 697, 699, 555

P.2d 1343 (1976). To maintain an action, a claimant “must have some real, substantial interest, as distinguished from a mere expectancy or contingent benefit.” **Herrold v. Case**, 42 Wn.2d 912, 916, 259 P.2d 830 (1953).

The indirect consequence that the assignees were able to pursue a valid claim against them is simply a “contingent benefit” as contemplated in the **Herrold** case. *Id.* Oldfield, Reid, Price, and Price do not have standing either under the traditional standing rule or under the class expressly created under § 1141(c).

Even if NW Commercial did not properly disclose the claims against the defendants,<sup>5</sup> the plain language of §1141(b) still vests that property in NW Commercial, and the plain language of § 1141(c) allows this case to go forward and the creditors of NW Commercial to assert their interests only after the Plaintiffs have won. This case should be remanded to enforce that plain language, rather than decided under **Stein** based on old law.

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<sup>5</sup> Plaintiffs do not concede that the claims were inadequately disclosed for the purposes of this case. *Supra* A.4.

**b. No fiduciary duties were owed to Oldfield, Reid, Price, and Price.**

Oldfield, Reid, Price, and Price cannot argue a violation of fiduciary duties by Mitchell because he had no fiduciary duties toward them.<sup>6</sup> See ORB 14, 19-20; BRRB 14-16; Price Response Brief (“PRB”) 8-9. Even if Mitchell had fiduciary responsibility to protect the interests of NW Commercial’s members and creditors, that responsibility would not extend to Oldfield, Reid, Price, and Price because he had no formal relationship with them on which those duties could be based. As emphasized above, Oldfield, Reid, Price, and Price were neither creditors nor members of NW Commercial. Any duties that Mitchell may have had to members and creditors do not extend to Oldfield, Reid, Price, and Price. As a result, plaintiffs’ claims against these parties would be unaffected even if Mitchell were found to have violated his fiduciary duties to members and creditors of NW Commercial.

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<sup>6</sup> Whether plaintiffs owed a duty to Byrne through the membership of his retirement fund in NW Commercial is a question of fact that should be decided on remand when the case is decided on the merits of the underlying claims.

**c. Post-confirmation, Mitchell was not in the same position as the bankruptcy trustee.**

Even if this court addresses the bankruptcy issue, there was no violation that invalidated the transfer. Plaintiffs argued that NW Commercial did not have the responsibilities of a trustee after confirmation of the bankruptcy plan. BA 24. Oldfield responds by citing authority that debtors in possession are subject to the same obligations as the bankruptcy trustee. ORB 16-17. Oldfield does not acknowledge the critical distinction that NW Commercial's bankruptcy plan had already been confirmed. After the plan was confirmed, NW Commercial ceased to have the responsibilities of a trustee and only had responsibilities to abide by the plan filed with the court. 11 U.S.C. § 1142. Confirmation vested all property of the estate in NW Commercial, which Mitchell duly managed. 11 U.S.C. § 1141(b).

Oldfield's own precedent does not support his claim. Oldfield argues, "confirmation of a plan [does not have the] effect of barring the trustee or debtor in possession from pursuing undisclosed assets of the estate." ORB 17 (quoting *In re Auto West, Inc.*, 43 B.R. 761, 763 (D. Utah 1984)). Neither the trustee nor the debtor in possession is pursuing the purportedly

undisclosed assets in this case. In fact, parties with no standing whatsoever with respect to the bankruptcy are trying to assert rights that they do not have. *Supra* A.3.a.iii. Although a trustee or a debtor in possession may be able to claim undisclosed assets, neither is so asserting here. The fact that one party has enforceable rights does not logically lead to the conclusion that other, unrelated parties can assert those rights to their own advantage. The transfer is not invalid on that basis.

**d. The assignment did not violate § 363 or § 554.**

Disputing plaintiffs' argument that the assignment of claims did not violate the bankruptcy code, BA 24, defendants argue that NW Commercial violated either 11 U.S.C. § 363 or § 554. ORB 15-17; BRRB 16-18; PRB 9. Both sections of the Bankruptcy Code are inapplicable here.

Section 363 lays out the duties of the trustee in the use, sale, or lease of property. 11 U.S.C. § 363. However, "[o]nce confirmation occurs, there is no longer a trustee (*i.e.*, the debtor in possession) to whom property can be delivered, or an estate that can benefit. Furthermore, § 363 does not apply to a reorganized debtor." ***Penthouse Media Group v. Guccione***, 335 B.R. 66, 75 (Bankr. S.D.N.Y. 2005). Section 363 is intended to cover cases of

transfer while the bankruptcy is still pending. After confirmation of a plan, § 363 is flatly inapplicable and no longer imposes any duties on the debtor. *Id.*

11 U.S.C. § 554 does not apply because NW Commercial never abandoned its claims. NW Commercial transferred the claims against the current defendants in exchange for five percent of the recovery and the privilege of recovering without paying for the cost of the lawsuit. This was a true sale of an asset that did not have significant value to NW Commercial due to its inability to finance a lawsuit to pursue its meritorious claims. Moreover, “section 554(c) has no applicability to . . . any chapter 11 case after a plan has been confirmed and the property of the estate has reverted in the debtor.” *In re JZ, LLC*, 357 B.R. 816, 822 (Bankr. D. Idaho 2006), *aff’d* \_\_\_ F.3d \_\_\_, 2007 Bankr. Lexis 2293 (B.A.P. 9th Cir. 2007) (quoting *Wells Fargo Bank, N.A. v. Nicolaysen (In re Nicolaysen)*, 228 B.R. 252, 261 (Bankr. E.D. Cal. 1998)). Here, the plan had been confirmed, and all property reverted in the debtor. 11 U.S.C. § 1141(b). Therefore, § 554 is inapplicable.

Sections 363 and 554 do not apply to this case. None of the defendants has cited any other section of the bankruptcy code that was violated by NW Commercial’s transfer.

**e. A breach of fiduciary duties would not invalidate the assignment.**

As plaintiffs argued in opening, a breach of fiduciary duties does not give rise to the conclusion that a transfer is invalidated. BA 23-24. Defendants do not respond to this argument, but simply continue to assert that violation of their fiduciary duties would render the assignment invalid. ORB 14, 19-20; BRRB 14-16; PRB 8-9. Oldfield asserts without support that the assignment was invalid simply because he alleged that Mitchell breached his fiduciary duties. ORB 14. However, a breach of fiduciary duties in bankruptcy gives rise to a damages claim, not the invalidation of the assignment. See *Connecticut General Life Ins. Co. v. Universal Ins. Co.*, 838 F.2d 612, 621 (1st Cir. 1998) (“federal courts have uniformly held that bankruptcy trustees are subject to personal liability for the willful and deliberate violation of their fiduciary duties. Some courts have even held that personal liability can be imposed for negligent acts by a trustee, at least where discretionary judgments are not involved.” (citations omitted)). Defendants have cited no authority supporting the claim that breach of fiduciary duties by Mitchell would invalidate an assignment of property. If the trial court were to find that Mitchell did violate his

fiduciary duties, it should conclude that he might be liable, not that his assignment is invalidated.

**f. There was no bankruptcy violation in this case.**

Defendants have argued at length that NW Commercial violated its fiduciary duties in its handling of the bankruptcy proceeding. Four of the five remaining defendants have no standing to make those arguments with respect to a bankruptcy to which they were only indirectly related. *Supra* A.3.a.iii. Furthermore, this argument is irrelevant to this case because it could only arguably lead to the conclusion that Mitchell and NW Commercial breached fiduciary duties. A breach of fiduciary duties causes the actor to be liable for damages, not an invalidation of the assignment, as the defendants claim without support. *Supra* A.3.e. Whether Mitchell would be liable for damages is inconsequential for the purposes of the current lawsuit.

Finally, even addressing the bankruptcy issue, defendants have found no applicable provision of the bankruptcy code that would invalidate this assignment and have based their arguments on outdated law. *Supra* A.3.a.i., A.3.d. The trial court erred in deciding part of this case on the basis of the bankruptcy issues, even if the claims were undisclosed.

**4. The claims against defendants Byrne, Reid, Price, and Price were validly listed in the bankruptcy schedules.**

NW Commercial disclosed its future claim against the former members of NW Commercial. CP 288. Although it would have been more precise to list these claims as claims against the members of the former managers of NW Commercial, rather than the former members of NW Commercial, this change in wording makes no difference. This listing undeniably contemplated the lawsuit at hand and gave notice to the bankruptcy court that these claims could arise.

It makes no difference to the defendants that the wording was not precise in the bankruptcy schedule. Defendants are not creditors of NW Commercial and have no interest in the claims in dispute. The important fact is that the bankruptcy court was put on notice of potential claims of this nature. It was error to dismiss meritorious claims on the basis of imprecise language when the bankruptcy court was notified of these potential claims, the defendants had no interest in the proceedings, and more precise language would have made no difference to these defendants whatsoever.

**5. Plaintiffs should not be estopped from raising the malpractice claim against Oldfield.**

**a. Defendants only raised judicial estoppel in reply.**

The trial court erred in considering judicial estoppel because defendants only raised the issue in reply on summary judgment. BA 27. Oldfield insists that the issue of judicial estoppel was not first raised in his reply brief, but he fails to identify where it was raised.<sup>7</sup> ORB 20. Oldfield's failure to cite to his opening partial summary judgment motion confirms that the words "judicial estoppel" do not appear in the motion. CP 314-26. Judicial estoppel should not have been considered by the trial court and should not be considered on appeal. ***White v. Kent Medical Center, Inc., P.S.***, 61 Wn. App. 163, 168, 810 P.2d 4 (1991).

In light of the fact that this is an estoppel doctrine, it is especially important that the defendants slipped an argument into their reply without giving the plaintiffs a chance to respond. Plaintiffs could have argued more specifically that they did not learn of the claim against Oldfield until later if Oldfield had raised judicial

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<sup>7</sup> In an apparent concession that he first raised the issue in his reply, Oldfield argues that this Court can affirm on any ground not raised in the trial court. ORB 20.

estoppel in his motion. In addition, earlier notice would have permitted plaintiffs to move the bankruptcy court for leave to reopen the case and amend their notice as to the assigned claim. "After Confirmation, the Reorganized Debtor may, with approval of the Court, remedy any defect or omission or reconcile any inconsistencies in this Plan." CP 933. The assignment allowed a meritorious claim to proceed against the fraudulent parties that caused NW Commercial's bankruptcy, whereas NW Commercial did not have the assets (again due to the defendants) to pursue it at all. Given the potential creditor benefit with no risk, the bankruptcy court was likely to allow the assignment so that the lawsuit could create a windfall for the creditors of NW Commercial. See CP 933. By arguing in reply only days before the hearing, the defendants did not give that opportunity. An estoppel argument unfairly raised in reply is inequitable in itself.

**b. Plaintiffs cannot be judicially estopped because they did not know about the claims against Oldfield.**

Plaintiffs argued in their opening brief that they could not be judicially estopped because they did not know about the claims against Oldfield at the time of NW Commercial's bankruptcy. BA 26-27. Defendants apparently admit this argument by not

responding. ORB 20-23; BRRB 23; PRB 10-11. ***Hamilton v. State Farm Fire & Cas. Co.***, 270 F.3d 778 (9th Cir. 2001), on which defendants depend extensively, see ORB 21-22, states that judicially estoppel applies when the debtor has knowledge about potential claims during bankruptcy. BA 27; ORB 22 (quoting ***Hamilton***, 270 F.3d at 784). Judicial estoppel does not apply to the claims against Oldfield because NW Commercial did not know about their claims when filing for bankruptcy.

**c. No unfairness justifies judicial estoppel here.**

A court should consider three factors in considering a judicial estoppel claim:

(1) whether “a party's later position” is “clearly inconsistent with its earlier position”; (2) whether “judicial acceptance of an inconsistent position in a later proceeding would create the perception that either the first or the second court was misled”; and (3) “whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped.”

***Arkison v. Ethan Allen, Inc.***, \_\_\_ Wn.2d \_\_\_, ¶8, 160 P.3d 13 (2007) (quoting ***New Hampshire v. Maine***, 532 U.S. 742, 750-51, 121 S. Ct. 1808, 149 L. Ed. 2d 968 (2001)) (internal quotations omitted).

These factors are not satisfied here. (1) Incomplete disclosure is not inconsistent with this proceeding under the

Bankruptcy Code, where the creditors retain the right of pursuing the proceeds garnered by the claims at issue. *Supra* A.3.a.ii. (2) There is no perception that either court was misled by the plaintiffs when the plaintiffs notified the court that claims for breach of fiduciary duty existed. *Supra* A.4.; CP 288. The bankruptcy court certainly had information necessary to identify and consider the instant claims in the bankruptcy proceedings. (3) Oldfield, Reid, Price, and Price suffer no unfair detriment even if it is true that NW Commercial did not list the claim as an asset during bankruptcy or get approval for the assignment. The assignment did not alter the position of Oldfield, Reid, Price, and Price because they were neither creditors nor members of NW Commercial. Whether NW Commercial had approval of the bankruptcy court to make an assignment is of no concern to Oldfield, Reid, Price, and Price, meaning that no unfair advantage was gained. Therefore, judicial estoppel does not apply to the claims against them. See *Arkison*, at ¶8.

**d. Estopping the plaintiffs would unfairly punish NW Commercial's creditors.**

The Bankruptcy Appellate Panel for the Ninth Circuit cautions that creditors should not be punished by estopping a

debtor from pursuing assets that would benefit the creditors. “[T]he danger inherent in estopping the debtor is that one may inappropriately punish creditors. . . . [C]reditors are potentially doubly punished: first, when the asset is omitted; and second, when there is an estoppel from pursuing the asset. One should not become so angry at a debtor that a creditor is taken out and shot.” *In re JZ, LLC, supra*, at \*20. If the plaintiffs were estopped from pursuing their meritorious claims, the court would be punishing NW Commercial’s creditors. Instead, the far more equitable solution is to allow the plaintiffs to pursue the claims subject to claims of the creditors under 11 U.S.C. § 1142(c). *See supra* A.3.a.ii.

**6. Neither precedent nor policy prohibits the assignment of a legal malpractice claim by a limited liability company to its members.**

Plaintiffs showed in their opening brief that the trial court erred in dismissing the malpractice claim against Oldfield on the ground that legal malpractice claims cannot be assigned because our Supreme Court has held only that it violates public policy to permit “assignment of malpractice claims to an adversary in the same litigation that gave rise to the claim of malpractice. . . .” BA 29 (quoting *Kommavongsa v. Haskell*, 149 Wn.2d 288, 307, 67 P.3d 1068 (2003)). The Court declined to decide whether other

types of assignments might violate public policy. BA 30, (quoting **Kommavongsa**, 149 Wn.2d at 311). The policy considerations against assignment simply have no application to an assignment by a limited liability company to its own members. BA 29-30.

Oldfield argues baldly that “to allow assignment would make possible the commercial marketing of legal malpractice causes of action by strangers, which would demean the legal profession.” ORB 26 (quoting **Zuniga v. Groce, Locke & Hebdon**, 878 S.W.2d 313, 316 (Tex. Ct. App. 1994)). Oldfield relies on the fact that **Zuniga** was “cited with approval” by the **Kommavongsa** decision, ORB 26, but ignores the fact that **Kommavongsa** cited **Zuniga** expressly for the problems posed by “assignment of malpractice claims to an adversary in the same litigation that gave rise to the claim of malpractice . . . .” 149 Wn.2d at 310. These concerns are absent here.

Oldfield further cites **Goodley v. Wank and Wank, Inc.**, 62 Cal. App. 3d 389, 133 Cal. Rptr. 83 (1976), for policy arguments in favor of a general rule prohibiting assignment of legal malpractice claims. ORB 26. However, the Court in **Kommavongsa** noted these policy arguments in a footnote, 149 Wn.2d at 296, n.2, before expressly refusing to generally prohibit the assignment of legal

malpractice claims by accepting them, 149 Wn.2d at 311. Ultimately, the reasoning in *Kommavongsa* does not apply here, and the cases from other jurisdictions that were cited therein have only been adopted with respect to assignment of claims to an adversary.

**7. The court should have allowed the plaintiffs to amend the complaint to add NW Commercial as a plaintiff.**

In response to plaintiffs' argument that the trial court abused its discretion by refusing leave to allow NW Commercial as a plaintiff, BA 30-31, defendants Byrne and Reid cite only cases that refused to find abuse of discretion as to a party moving to amend their claims, rather than amending to add a real party in interest. BRRB 24. The cases are quite the opposite in the context of amending for the allegedly real party in interest in a bankruptcy context. In fact, since the filing of plaintiffs opening brief, the Washington Supreme Court has ruled that the proper remedy in a judicial estoppel case involving a bankruptcy filing is to allow the case to go forward with the bankruptcy trustee replacing estopped parties. *Arkison, supra*, at ¶¶13-14. This precedent shows that the broad discretion given the trial court in cases of amendment as to

the claims does not apply where the party moves to substitute the real party in interest from a bankruptcy estate.

Even if the court finds that the circumstances justify the use of judicial estoppel, precedent requires remand for the pursuit of the claim by NW Commercial on behalf of the bankruptcy estate. In ***Bartley-Williams v. Kendall***, 134 Wn. App. 95, 102, 138 P.3d 1103 (2006), the court held that even if judicial estoppel would estop Bartley-Williams from pursuing the claim because it was not listed during bankruptcy, the proper remedy is to allow the claim to be pursued by the bankruptcy estate trustee. The court reasoned that the bankruptcy estate and, in turn, the bankruptcy trustee, did not garner any unfair advantage from the non-disclosure of the asset under the first bankruptcy. *Id.* Applying the judicial estoppel doctrine simply creates a windfall for a negligent party at the expense of the bankruptcy creditors. *Id.* (citing ***In re An-Tze Cheng***, 308 B.R. 448, 459-60 (B.A.P. 9th Cir. 2004)).

The Washington Supreme Court explicitly agreed with ***Bartley-Williams*** in the recent ***Arkison v. Ethan Allen, Inc.*** case: “We agree. We hold that a trial court may not generally apply the doctrine of judicial estoppel to bar a bankruptcy trustee standing as the real party from pursuing a debtor's legal claim not listed as an

asset during bankruptcy proceedings.” *Arkison*, *supra* at ¶13. Accordingly, NW Commercial’s bankruptcy estate’s interest should not be judicially estopped. NW Commercial acted as a debtor in possession, which is equivalent to a bankruptcy trustee during a bankruptcy case. *In Re Cheng*, 308 B.R. at 455. Even if judicial estoppel were applied to this case, the proper remedy would be to allow NW Commercial, as debtor in possession with powers equivalent to a bankruptcy trustee, to pursue the distinct interests of the bankruptcy estate.<sup>8</sup> The trial court erred in refusing the third amended complaint that would have included NW Commercial as a plaintiff. See CP 1882. Precedent is clear that this is the proper remedy. *Arkison*, 160 P.3d 13; *Bartley-Williams*, 134 Wn. App. at 102-03. At the very least, the court should remand ordering a NW Commercial to substitute as plaintiff.

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<sup>8</sup> Alternatively, the bankruptcy court could appoint a trustee to pursue the claim if it believed that a trustee would be more appropriate as a plaintiff.

**B. Summary judgment on the statute of limitations was error where the facts present jury questions about when Mitchell and Grendahl learned elements of their claims, when they suffered damage, and whether Mitchell and Grendahl exercised due diligence.**

**1. The statute of limitations defense only affects some of the claims and some of the plaintiffs.**

Despite the fact that the burden is on the defendants to prove the statute of limitations had run for all plaintiffs, *Haslund v. City of Seattle*, 86 Wn.2d 607, 620, 547 P.2d 1221 (1976), defendants' evidence centers around the knowledge of only Mitchell and Grendahl. Without proof what the other plaintiffs knew and when they knew it, the starting time of the statute of limitations could not be established. BA 33; RCW 4.16.080. Tallman, Jacobsen, and Grenville each presented evidence that they did not learn of the claims until at least August 2001. CP 1364, 1536-38, 1699-700. This evidence was uncontroverted by the defendants, who held the burden of proof.

Only Byrne and Reid address in response whether the statute of limitations affected all plaintiffs. BRRB 27-28. However, defendants conveniently forget the standard of review that places the burden squarely on them during summary judgment. First, the defendants rehash their bankruptcy standing argument, which is irrelevant to the statute of limitations. BRRB 27. Second, they

seem to argue that Mitchell's knowledge is imputed to Tallman because they were married. BRRB 27. Defendants ignore that Mitchell and Tallman filed for divorce in 2001, and their communication during this critical period was "limited." CP 1535. Defendants fail to prove that Tallman knew all facts of which Mitchell became aware. Finally, they criticize the Mitchell Family Trust for not presenting more evidence to satisfy the burden of proof that is clearly on the defendants, not the plaintiffs. BRRB 27; *Haslund*, 86 Wn.2d at 620.

Defendants' arguments do not address plaintiffs' argument that defendants did not meet their burden of proof on summary judgment. The burden was on the moving party, the defendants, to prove that the statute of limitations had run for each of the plaintiffs against whom they were seeking summary judgment. Not having met that standard, summary judgment is inappropriate with respect to all parties other than Mitchell and Grendahl.

**2. None of the plaintiffs suffered damages until NW Commercial lost its collateral and was unable to repay its investments.**

Plaintiffs argued that they were not damaged by the defendants' fraudulent concealment until November 2001. BA 36-37. Defendants Byrne and Reid argue that Mitchell and Grendahl

were damaged when they attempted to obtain a disbursement from NW Commercial earlier in 2001 and were met with delay and evasion.<sup>9</sup> BRRB 28. However, those damages were caused not by the fraudulent concealment but by a breach of the liquidity provision in the contract. These are two separate causes of action with two separate statutes of limitations. There were no damages due to fraudulent concealment until at least November 2001.

Whether statutes of limitations begin simultaneously for two claims with common parties depends upon the rule for res judicata. ***Exhibitors Poster Exchange, Inc. v. National Screen Service Corp.***, 421 F.2d 1313, 1317 (5th Cir. 1970) (“the definition of a cause of action for purposes of determining whether the statute of limitations has run is the same one that should be used here for determining if res judicata is applicable.”) “[W]here the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted” in arguing the first action. ***Cromwell v. County of Sac***, 94 U.S. 351, 353 (1877). Therefore, the running of the statute of limitations should

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<sup>9</sup> Even if this argument were correct, it is obviously only relevant to plaintiffs Mitchell and Grendahl.

begin at the accrual of the first claim only if substantially the same issues would be argued with respect to the first claim as to the second.

Here, Byrne violated the liquidity provision of the NW Commercial contract by failing to disburse funds to plaintiffs when requested. CP 363. The issues, damages, and evidence surrounding that breach of contract are very different from the facts and issues surrounding the fraudulent misrepresentation and related contract claims that are central to this case. The damages from the breach of liquidity arose from a delay in time. The damages from the fraudulent misrepresentation arose from the loss of investment, which did not occur until much later, after August 2001. Even if the earlier breach of liquidity claims are barred by the statute of limitations, the statute of limitations for the fraud is not affected.

Damages from the fraud claim itself must have occurred for the claims to have accrued. “The mere danger of future harm, unaccompanied by present damage, will not support a negligence action.” *Haslund*, 86 Wn.2d at 619 (quoting *Gazija v. Nicholas Jerns Co.*, 86 Wn.2d 215, 219, 543, P.2d 338 (1975)). Byrne continued to assure plaintiffs that there would be sufficient equity in

the Graham Square property for the plaintiffs to recover their investments in August 2001. CP 1358-59, 1625. Plaintiffs did not lose their investments until at least November 2001. BA 36-37. Therefore, the claims did not accrue until at least November 2001, and the statute of limitations did not expire before the initial filing of this claim in July 2004.

**3. The parties dispute when Mitchell and Grendahl learned the truth and whether they exercised due diligence.**

Plaintiffs' opening brief showed that the parties dispute the application of the discovery rule to when Mitchell and Grendahl should have learned through due diligence that they had claims against the defendants. BA 37-43. Under the discovery rule, the accrual of the statute of limitations is tolled until the plaintiff knows, or through the exercise of due diligence, should have known all the facts necessary to establish a legal claim. BA 37-39. The plaintiff is charged with what a reasonable inquiry would have discovered, and analysis of due diligence raises issues of fact. *Id.*

Byrne and Reid claim that the Woodell letter establishes that the plaintiffs had sufficient knowledge to trigger the running of the statute of limitations. BRRB 33-34. But Byrne and Reid tellingly omit the portion of the letter that states that the plaintiffs lack

knowledge of all pertinent facts and that they need access to relevant documents:

We are so concerned that we do not yet have all the pertinent facts, we must demand that our accountant, William R. Stevens, be given immediate access to NW Commercial Loan Fund records to audit the status of loan portfolios and accounts.

CP 1200. Rather than asserting the underlying facts as the defendants allege, the letter states that there are reasonable grounds for believing, then demands more information.

This is a classic case of due diligence. The plaintiffs exercised due diligence, and they are charged with what a reasonable inquiry would reveal. But when are they charged with that knowledge? When they first demanded the information, or when they received the information? The inherent logic of the due diligence rule gives the plaintiffs a reasonable amount of time to investigate the facts and discover the truth. The doctrine is intended to protect against the unfairness of cutting off a plaintiff's claim "where the plaintiff, due to no fault of her own, could not reasonably have discovered the claim's factual elements until some time after the date of the injury." ***Crisman v. Crisman***, 85 Wn. App. 15, 20, 931 P.2d 163, *rev. denied*, 132 Wn.2d 1008 (1997).

In other words, the plaintiff must have a reasonable time to discover the claim's factual elements. The Woodell letter was a reasonable and diligent effort to learn the truth, and the statute of limitations did not begin to run until a reasonable time after Woodell sent the letter and the plaintiffs learned the truth. Unfortunately, Byrne's response to the Woodell letter was to continue to make false reassurances to the plaintiffs, lulling them into a false sense of security. BA 13.

Byrne and Reid claim that Mitchell "admits that in June of 2001, he, Grendahl and Stevens had discovered on their own the investments which formed the basis of their claim against the Respondents." BRRB 34 (citing CP 365). Of course, Mitchell says no such thing. He says "by that time" he had learned that some of Byrne's representations were false. CP 365. By what time? Judging from the context the statement refers to sometime after a distribution was due. *Id.* The statement is at best ambiguous and conflicts with other unequivocal statements by Mitchell that he did not learn the truth until August 2001. BA 14, (quoting CP 1370). On this summary judgment appeal, plaintiffs are entitled to the benefit of any ambiguities or inferences and to rely on Mitchell's

firm statement; they are not bound by an unclear and ambiguous reference.

Byrne and Reid again rely heavily on the Yanick memo, BRRB 35-36, ignoring the plaintiffs' point that there is no apparent theory on which the Yanick memo is admissible evidence. BA 17, 39. Byrne and Reid claim that the memo is offered "to inform the court of what Appellants knew and when they knew it." BRRB 35-36. The best that can be said for this statement is that it shows a profound ignorance of the rules of evidence. The memo is unmitigated hearsay—it is a writing by someone who hasn't testified by deposition or declaration that any of these things were said or known by anyone, let alone the plaintiffs. It is clearly offered for the truth of the matter asserted, which makes it blatant hearsay.

Byrne and Reid make the absurd claim that the plaintiffs do not dispute Yanick's memo. BRRB 36. The memo is contrary to the plaintiffs' sworn assertions, to Byrne's own account of the facts, and it is internally contradictory. BA 14-18. The Yanick memo cannot paper over these issues of fact.

It is irrelevant that the Yanick memo opined that the plaintiffs should file the lawsuit by February 2004. See CP 1241. Yanick's advice is not the legal standard for the statute of limitations, and

that standard is not affected by notice to the plaintiffs advising them to be prudent. See *supra* B.2. The court must decide the statute of limitations argument based on the legal standard, not on an evaluation of their prudence or the notice they were given. See *supra* B.2.; cf. PRB 20.

Actual knowledge will only be imputed to the plaintiffs if due diligence could have uncovered it. ***Busenius v. Horan***, 53 Wn. App. 662, 667, 769 P.2d 869 (1989). Mere suspicion of wrong is not discovery of the fraud. *Id.* (citing ***Davison v. Hewitt***, 6 Wn.2d 131, 137, 106 P.2d 733 (1940)).

Defendants have removed the time element of the analysis. All evidence suggests that a diligent search was conducted and that it concluded with knowledge of the underlying facts in August 2001.<sup>10</sup> This case is analogous to the ***Busenius*** case where the court held:

Although notice that would lead a party to inquire further is notice of everything to which such an inquiry would lead, neither in the briefs nor in argument did Horan present any basis on which we could find that inquiry in December of 1981 would have disclosed his causes of action.

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<sup>10</sup> At worst, whether the search constituted due diligence is a matter of fact that would need to be decided by a factfinder on remand.

53 Wn. App. at 668. The ***Busenius*** court then reversed summary judgment dismissal on grounds that the start of the running of the statute of limitations was a question of fact. *Id.* The ***Busenius*** case shows that the important inquiry is whether a duly diligent search would have been able to discover the underlying facts of the fraud *at that time*.

While Mitchell and Grendahl were diligently investigating their suspicions of fraud, the defendants were still assuring Mitchell and Grendahl that the loans were secure into August 2001 and stonewalling their investigation. CP 1358-59, 1625. The defendants did not give them access to NW Commercial's accounts as requested in the Woodell letter and assured them that NW Commercial would have enough money to repay them. CP 1358-59. This stonewalling belies the claim that plaintiffs could have discovered the underlying facts of the fraud with a duly diligent search. Moreover, this fraudulent concealment activates the discovery rule, which tolls the accrual of the claim until a diligent search would discover the facts of the fraud—August 2001. ***Crisman***, 85 Wn. App. at 20-21; RCW 4.16.080.

The plaintiffs were duly diligent and did not uncover the facts of the fraud until August 2001, within three years of the filing of this

case. It would be grossly unjust to impute the knowledge of a duly diligent investigation to them in July when the defendants' stonewalling frustrated the Grendahl's diligent investigation of the truth.

**4. The recording of the deeds did not provide constructive notice.**

As plaintiffs argued in their opening brief, the 1999 filing of three deeds of trust from NW to NW Commercial did not give them constructive notice. BA 42-43. In response, defendants simply rehash their argument first brought up in reply in the second summary judgment motion. BRRB 32-33. Defendants do not respond to plaintiffs' cited precedent that constructive notice is given only to a party who has "*reason to refer to the record in which the document is recorded.*" ***Aberdeen Fed. Sav. & Loan Ass'n v. Hanson***, 58 Wn. App. 773, 777, 794 P.2d 1322 (1990) (emphasis in original); See BRRB 32-33. Moreover, defendants ignore that constructive notice of fraud is applied only if examination of the record could have been discovered examining the record and if "ordinary prudence and business judgment" required such examination. ***Aberdeen Fed. Sav.***, 58 Wn. App. at 777 (quoting ***Irwin v. Holbrook***, 32 Wash. 349, 357, 73 P. 360 (1903)). BA 42.

Byrne and Reid have made no showing that discovery could or should have been discovered by examination of the filing record of the deeds of trust. The filing of the deeds of trust failed to provide plaintiffs with constructive notice.

**5. The statute of limitations had not run for contract claims.**

Even if the court were to affirm the trial court with respect to the fraud claims, it should reverse as to contract claims with a six-year statute of limitations that still remain. RCW § 4.16.040. The court should remand with respect to those claims.

Oldfield claims that he had no contract with the plaintiffs and would only be liable in a tort action. ORB 31-32. The plaintiffs did not need personal contracts with Oldfield because they received their claims by transfer from NW Commercial—an assignment that Oldfield discussed thoroughly. ORB 14-28. Oldfield only denied that assignment existed when it was convenient for him to do so.

If the court finds that the assignment was valid, the contract claims remain with the plaintiffs and do not suffer problems with the

statute of limitations.<sup>11</sup> If the court finds that the assignment was invalid, the proper remedy is to allow NW Commercial to go forward with the contract claims. *Supra* A.7.; ***Bartley-Williams v. Kendall***, 134 Wn. App. 95, 102-03, 138 P.3d 1103 (2006). These claims also would not be barred by the statute of limitations as contract claims have a six-year statute. RCW § 4.16.040.

**C. The defendants' other arguments are meritless.**

**1. Appellants had independent and transferred claims.**

Oldfield argues that plaintiffs' malpractice claims against him should be dismissed as improper claims because the plaintiffs are members of NW Commercial, rather than NW Commercial itself, which was his client. ORB 31. Of course, Oldfield forgets that NW Commercial transferred its claims to the plaintiffs.

Additionally, plaintiffs had independent tort claims based on Oldfield's misrepresentation and violation of a duty to disclose. CP 1014-20. Plaintiffs claim that Oldfield had a responsibility as attorney for the entity NW Commercial to speak up when the

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<sup>11</sup> The court below never ruled whether most of the claims against Oldfield violated the statute of limitations because they were dismissed in the first partial summary judgment order holding the assignment invalid. CP 999-1001.

managers were acting clearly contrary to the formation agreement. CP 1012-13. These claims are completely unaffected by the issue of the validity of the assignment, as the claims did not require transfer from NW Commercial to be litigated. Plaintiffs sue on the basis of independent harm. The case should be remanded on these claims, among others, regardless of the determination of the bankruptcy issue.

## **2. The claims against Oldfield survive.**

In arguing that there was not evidence of fraud or misrepresentation against him, Oldfield relies on a case where counsel was involved only with the “usual drafting and filing services provided by counsel” in the offering of a security. *Hines v. Data Lines Systems, Inc.*, 114 Wn.2d 127, 149, 787 P.2d 8 (1990); ORB 29-30. In fact, in *Hines*, the court noted, “[T]here is no evidence to indicate Perkins Coie had any personal contact with any of the investors or was in any way involved in the solicitation process.” *Hines*, 114 Wn.2d at 149.

Here, the plaintiffs do not allege that Oldfield was fraudulent in his drafting of the PPM. *Cf.* ORB 28. Instead, the plaintiffs allege that Oldfield learned later that defendants had breached the terms of the PPM and concealed or failed to disclose these facts to

the members of NW Commercial, despite his duties as NW Commercial's attorney. CP 1012-13: 2.13. In support of this claim, plaintiffs have evidence that Oldfield knew that Byrne and Reid had violated the PPM, CP 1565, that Oldfield did not disclose these violations to the members of NW Commercial despite representing NW Commercial as an entity, CP 1616-17, and that Oldfield's non-disclosure allayed the plaintiffs' concerns causing further harm. *Id.*

Oldfield has misconstrued plaintiffs' claims to focus on his knowledge at the drafting of the offering memorandum, and in doing so, he has cited irrelevant precedent. Plaintiffs' true claim is that Oldfield was negligent during the meetings of 2001 and that his silence constituted a misrepresentation by omission. CP 1019-20: 9.1-9.3. Plaintiffs have ample evidence to show Oldfield's negligence and misrepresentation, and the case should be remanded to decide this issue.

**3. The court should remand the case to decide issues on the merits.**

Each defendant has presented a scattering of brief arguments on the merits imploring the court to decide this case on the basis of minimal argument and little precedent. See, e.g., ORB 27-31; BRRB 44-48; PRB 24-27. An appellate court may sustain a

trial court ruling on any ground, even if the ground was not considered below. **Nast v. Michels**, 107 Wn.2d 300, 308, 730 P.2d 54 (1986). However, the record must be sufficiently developed for the appellate court to decide the issue. RAP 2.5(a). "An insufficient record on appeal precludes review of the alleged errors." **Stansfield v. Douglas County**, 107 Wn. App. 1, 8, 27 P.3d 205 (2001) (quoting **Bulzomi v. Dep't of Labor & Indus.**, 72 Wn. App. 522, 525, 864 P.2d 996 (1994)).

Here, the record is clearly insufficient for this Court to affirm the summary judgment ruling based on the merits of the case. Because the defendants moved for summary judgment solely on procedural grounds, CP 307-09, 1130, the plaintiffs have not had an opportunity to present their case on the merits. Now, on an appeal of the procedural summary judgment rulings, the defendants attempt to throw in arguments in an effort to win before the plaintiffs have had the opportunity to present their case. This should remain an appeal on the procedural issues around which the record has been formed, as was established by the procedural summary judgment motions. This Court should not consider the merits of the underlying case with an insufficient record and should remand for consideration thereon by the trial court. RAP 2.5(a).

**D. Plaintiff's claims were not frivolous because they were not advanced without reasonable cause and several of defendants' theories were unresolved or issues of first impression.**

**1. Plaintiffs' case is not frivolous on the whole.**

The plaintiffs opening brief established that RCW 4.84.185 was intended to "apply to actions which, *as a whole*, were spite, nuisance or harassment suits." ***Biggs v. Vail***, 119 Wn.2d 129, 135, 830 P.2d 350 (1992); BA 46. In response, defendants never address this standard. ORB 35-37; BRRB 38-40; PRB 27-28. None of the defendants makes any argument that this lawsuit was motivated by spite, nuisance, or harassment. This lawsuit was motivated by a total loss of investment due to the fraudulent actions of the defendants and the negligent representation of their LLC's attorney in protecting their interests. The goal was to recover the millions of dollars lost due to fraud, misrepresentation, and breach of contract. This is an inappropriate case for a fee award.

The standard requires that the court look at the actions *as a whole* to evaluate the plaintiffs' intentions for the purpose of awarding fees. ***Biggs***, 119 Wn.2d at 135. Even if the court should rule in favor of the procedural arguments about the statute of limitations or the listing in bankruptcy, the fact remains that plaintiffs

sued to recover lost money fraudulently managed by the defendants. There was no malice or nuisance.

The defendants erroneously emphasize the Yanick memo as a primary basis for the attorney's fees award. ORB 37. However, the Yanick memo simply represents the opinion of a lawyer who acknowledges that the timeline needs to be "clarified." CP 1236. Importantly, even the defendants do not argue that the statute of limitations required filing in February 2004. The relevant inquiry centers on whether the case needed to be filed before or after August 2004. *Compare* BA 37 *with* BRRB 33-34. The fact that a lawyer wrongly believed that that the statute of limitations was much earlier does not make it frivolous for the plaintiffs to depend on another lawyer, who disagrees and files a later claim.

The Woodell letter also does not satisfy the standard required to award attorney's fees. The Woodell letter simply notes that the plaintiffs have suspicions, then demands access to the files so that the plaintiffs could conduct a diligent search. CP 1199-201. The defendants would have this court infer from that letter that the plaintiffs were on notice of the fraud through the discovery rule. However, mere suspicion is not enough. *Busenius v. Horan*, 53 Wn. App. 662, 667, 769 P.2d 869 (1989). The discovery rule only

imputes knowledge of the fraud on the plaintiffs when a search in due diligence should have given them that knowledge. *Id.*

No evidence has been presented to this court that would support the finding that the plaintiffs should have been more diligent in their search. The defendants would have the Woodell letter be read to be the end of a fruitful search, but the Woodell letter explicitly identifies itself as the beginning of that search by asking for access to documents. CP 1200.

In contemplating attorney's fees, the moving party must overcome the high standard requiring that none of the arguments is reasonable. ***Crisman v. Crisman***, 85 Wn. App. 15, 24, 931 P.2d 163, *rev. denied*, 132 Wn.2d 1008 (1997). Here, defendants have not argued that the plaintiffs were anything but diligent in their search or that a more diligent search would have discovered the underlying facts in July. Instead, they have conflated suspicion with knowledge and omitted mention that plaintiffs could not discover the underlying facts in July because the facts were fraudulently concealed by the defendants. This does not approach the high standard that would allow an attorney's fees award.

## 2. Defendants raise novel issues of law.

A case dismissed on summary judgment is not frivolous if it presents issues of first impression. **Jeckle v. Crotty**, 120 Wn. App. 374, 387, 85 P.3d 931, *rev. denied*, 152 Wn.2d 1029 (2004). In arguing, Oldfield notes, “Washington’s Supreme Court has not yet expressly addressed the question of whether legal malpractice claims are assignable in situations other than those involving former adversaries.” ORB 26 (citing **Kommavongsa v. Haskell**, 149 Wn.2d 288, 311, 67 P.3d 1068 (2003)). This case presents precisely that unaddressed issue. ORB 25-26.

The treatment of undisclosed property after confirmation of a bankruptcy plan was at least undecided at trial, **In re JZ, LLC**, 357 B.R. 816, 822 (Bankr. D. Idaho 2006), if not already overruled in plaintiffs’ favor. *Supra* A.3.a. The **Stein** case that seems to support the defendants’ position was, in fact, decided under the Bankruptcy Act of 1898. rather than the current Bankruptcy Code. *Id.*; **Stein v. United Artists Corp.**, 691 F.2d 885, 888 n.1 (9th Cir. 1982). Under 1141(b), **Stein** clearly does not apply. **In re JZ, LLC**, *supra* at \*10-\*44. The assignment of NW Commercial’s claims against the defendants was valid and it would be generous to the defendant to read the law as undecided.

With respect to the statute of limitations, this case presents the unusual factual scenario of plaintiffs who actually exercised due diligence and demanded documents to learn the truth. Prior discovery rule cases are unclear—plaintiffs contend that the statute of limitations does not begin to run until a reasonable time after plaintiffs knew of the potential problems and began their investigation, while defendants contend that the statute began to run as of Woodell’s inquiry about the facts. The precise time at which the statute begins to run under the due diligence rule is an undecided question.

As a result, under **Jeckle**, 120 Wn. App. at 387, the trial court erred in awarding attorney’s fees to the defendants because the case presented issues of first impression.

### **3. Plaintiff’s claims survive for remand.**

“[I]f any claims advance to trial, a trial court’s award of fees under RCW 4.84.185 cannot be sustained.” **State ex rel. Quick-Ruben v. Verharen**, 136 Wn.2d 888, 904, 969 P2d 64 (1998). As pointed out in plaintiffs’ opening brief, the trial court decided summary judgment on the claims transferred from NW Commercial to the plaintiffs only on the basis of an invalid transfer. BA 32; CP 999-1001 Moreover, defendants admit that summary judgment

would not have been appropriate for these claims based on the statute of limitations. BRRB 27.

However, even if this court finds that the assignment was invalid, recent Supreme Court precedent makes clear that the proper remedy with respect to the assignment was either to appoint a trustee to pursue the case for the bankruptcy estate or to allow NW Commercial, as debtor-in-possession in place of the to pursue the case for the estate. *Supra* A.7.; see **Arkison**, *supra* at ¶¶13-14; **Bartley-Williams v. Kendall**, 134 Wn. App. 95, 102, 138 P.3d 1103 (2006). NW Commercial should have been allowed to join or replace the plaintiffs in this case to prevent an unjust result against NW Commercial's creditors. Because these claims should still survive, attorney's fees are inappropriate under **Quick-Ruben**. 136 Wn.2d at 904.

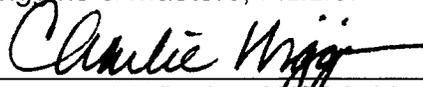
As a whole, it would be contrary to the legislative intent to award attorney fees in this case with myriad debatable and formalistic issues surrounding meritorious claims against fraudulent defendants. Novel issues have been raised, claims survive summary judgment, and, most importantly, reasonable minds clearly could differ as to these hotly contested issues.

## CONCLUSION

The court should reverse the summary judgment and the trial court's award of a quarter million dollars in attorney fees under RCW 4.84.185 and remand for trial.

RESPECTFULLY SUBMITTED this 20 day of July 2007.

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CERTIFICATE OF SERVICE BY MAIL

I certify that I mailed, or caused to be mailed, a copy of the foregoing REPLY BRIEF postage prepaid, via U.S. mail on the 20 day of July 2007, to the following counsel of record at the following addresses:

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