

No. 36121-3-II

**COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON**

STATE OF WASHINGTON
COURT OF APPEALS, DIVISION II
CLERK OF COURT
JULY 10 2013

DENNIS SAVIANO,

Appellant,

v.

WESTPORT AMUSEMENTS, INC., an inactive Washington Corporation, **HAROLD PRATER** and **DAWN PRATER**, husband and wife, and the marital community composed thereof,

Respondents.

REPLY BRIEF OF RESPONDENTS PRATER

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TABLE OF CONTENTS

I. ISSUES RELATING TO ASSIGNMENTS OF ERROR 1

 1. Whether substantial evidence supports the trial court’s finding that Saviano contributed \$179,108.00 between 2003 and 2006 to preserve the assets of the corporation and parties? 1

 2. Whether substantial evidence supports the Trial Court’s finding that Saviano undertook a course of action that involved self dealing to recover his past and future investments by executing a promissory note on behalf of the corporation in favor of himself, where such note had the effect of diluting the minority shareholder’s equity?..... 1

 3. Whether Saviano, as the majorit shareholder in control of the corporations management and assets, breached his fiduciary duties to the minority shareholders by attempting to convert their equity into secured debt in favor of himself?..... 1

 4. Whether the Trial Court correctly determined that the April 15, 2006 promissory note was unenforceable on the basis that it was the product of illegal self-dealing on the part of Saviano? 1

 5. Whether the trial court appropriately exercised its discretion in awarding Saviano \$179,108.00 from the net sale proceeds of the corporate assets as reimbursement of costs he expended to preserve the assets between 2003 and 2006? 1

II. RESPONDENTS’ COUNTERSTATEMENTS OF THE CASE..... 1

III. ARGUMENT..... 6

 A. Standard of Review..... 6

 B. The Trial Court correctly found the April 16, 2006 Promissory Note unenforceable as being executed through self-dealing in breach of Saviano’s fiduciary duties to the other shareholders. 7

 C. Substantial evidence supports the Trial Court’s finding that Saviano’s actions on behalf of the corporation and personally were conflicting, resulting in self-dealing. 8

 D. The Trial Court correctly characterized Saviano’s role in advancing funds as that of a “quasi receiver”..... 11

IV. CONCLUSION..... 14

TABLE OF AUTHORITIES

CASE LAW

<i>Astin v. Carden</i> , 194 Ga. 758, 22 S.E.2d 481 (1942).....	12
<i>Auburn Mechanical, Inc. v. Lydig Const., Inc.</i> , 89 Wn. App. 893, 951 P.2d 311 (1998).....	13
<i>Beall v. Pacific Nat. Bank of Seattle</i> , 55 Wn.2d 210, 347 P.2d 550 (1959).....	8
<i>Dailie Communications, Ltd. v. Trend Bus. Sys., Inc.</i> , 61 Wn. App. 151, 810 P.2d 12 (1991).....	13
<i>Evans v. Luster</i> , 84 Wn. App. 447, 92 P.2d 455 (1996).....	10
<i>Frankel v. Frankel</i> , 212 Ga. 643, 94 S.E.2d 728 (1956).....	12
<i>Gentile v. Rossette</i> , 906 A.2d 91 (Del. 2006).....	9
<i>Guth v. Loft, Inc.</i> , 5 A.2d 503 (Del. 1939).....	9
<i>Holland v. Boeing Co.</i> , 90 Wn.2d 384, 583 P.2d 621 (1978).....	6
<i>Huggins v. Huggins</i> , 43 S.E. 759 (Ga. 1903).....	12
<i>In Re Stewart</i> , 179 F. 222 (6 th Cir. 1910).....	12
<i>Interlake Porsche & Audi, Inc. v. Bucholz</i> , 45 Wn. App. 502, 728 P.2d 597 (1987).....	8, 9
<i>Ivanhoe Partners</i> , 535 A.2d 1334 (Del. 1987).....	9
<i>Liddell v. Johnson</i> , 213 Ga. 752, 101 S.E.2d 755 (1958).....	12

<i>Naste v. Michels</i> , 107 Wn.2d 300, 730 P.2d 54 (1986).....	12
<i>Nguyen v. Dep't of Health, Med. Quality Assurance Comm'n</i> , 144 Wn.2d 51, 29 P.3d 689 (2001).....	6
<i>Patel v. Patel</i> , 627 S.E.2d 21 (Ga. 2006).....	11
<i>Standing Rock Homeowner's Ass'n v. Misich</i> , 106 Wn. App. 231, 23 P.3d 520 (2001).....	7
<i>State v. Scott</i> , 110 Wn.2d 682, 757 P.2d 492 (1988).....	7
<i>Sunnyside Valley Irr. Dist. v. Dickie</i> , 111 Wn. App. 209, 43 P.2d 1277 (2002).....	7
<i>Unocal Corp. v. Mesa Petroleum Co.</i> , 493 A.2d 946 (1985).....	9
<i>Weinberger v. UOP, Inc.</i> , 457 A.2d 701 (Del. Sup. 1983).....	9
<u>STATUTES</u>	
RCW 23B.08.010(2).....	8
<u>OTHER AUTHORITIES</u>	
19 CJS <i>Corporations</i> , Sec. 556.....	8

I. ISSUES RELATING TO ASSIGNMENTS OF ERROR

1. Whether substantial evidence supports the trial court's finding that Saviano contributed \$179,108.00 between 2003 and 2006 to preserve the assets of the corporation and parties?

2. Whether substantial evidence supports the Trial Court's finding that Saviano undertook a course of action that involved self-dealing to recover his past and future investments by executing a promissory note on behalf of the corporation in favor of himself, where such note had the effect of diluting the minority shareholder's equity?

3. Whether Saviano, as the majority shareholder in control of the corporation's management and assets, breached his fiduciary duties to the minority shareholders by attempting to convert their equity into secured debt in favor of himself?

4. Whether the Trial Court correctly determined that the April 15, 2006 promissory note was unenforceable on the basis that it was the product of illegal self-dealing on the part of Saviano?

5. Whether the trial court appropriately exercised its discretion in awarding Saviano \$179,108.00 from the net sale proceeds of the corporate assets as reimbursement of costs he expended to preserve the assets between 2003 and 2006?

II. RESPONDENTS' COUNTERSTATEMENTS OF THE CASE

Westport Amusements, Inc. (Westport) is a Washington corporation formed in 1993 by Dennis Saviano (Saviano) and Harold and Dawn Prater (Praters). Saviano holds fifty-five percent of the

corporation's stock, and the Praters collectively own forty-five percent. The sole purpose of Westport was the operation of the Westport Family Fun Center, a family amusement complex. Finding of Fact 1; RP 91-92.

At the time of the formation of the corporation, the Praters and Saviano agreed that the Praters would receive a \$40,000.00 per year salary to compensate them for the \$40,000.00 per year salary Dawn Prater would give up by leaving her job in Michigan to participate in the Fun Center. RP 95. The Praters and Saviano jointly pursued the venture between 1993 and 2002, with Saviano providing most of the funding, and the Praters devoting their time, energy, and (to a lesser extent than Saviano) money to actually operating and developing the amusement park. Finding of Fact 2. The Praters had total responsibility for the construction, management, operation, and financial reporting of Westport from January 1993 through October 31, 2002. RP 15-16.

Dawn Prater kept a hand-written ledger and created a trial balance to track the parties' respective capital contributions through December 31, 2002 (Exhibits 30, 31, and 32.) The Praters were only able to match Saviano's capital contributions dollar for dollar up to about \$126,000.00. (RP 93-94.)

The business initially did well between 1993 and 2002. During this time, the Praters put time and money into developing the business, foregoing wages, with the exception of \$13,499.81 in 1998. RP 97. The profits from the business that would have been used to pay the Praters' wages went to expand the operation and to pay operating costs during the

off-season. RP 100-101. In 1997, Dawn Prater took a full-time job as a bookkeeper for a local seafood company to ease the strain on the Praters' personal finances due to not receiving wages. RP 99, 101. Harold Prater kept operating the park full time, and Dawn would work after hours until the park closed, and weekends. RP 101.

The local economy suffered, resulting in a slump in Westport's revenues. RP 101. Dennis Saviano stated in an April 28, 2002 letter to the Port of Grays Harbor County (Exh. 2, p. 49):

I have never taken out one cent for my time or the money that I have put into the fun center. I personally have over \$400,000.00 in the fun center. Harold and Dawn haven't taken any money out either. **They haven't even been able to take wages or other compensation out for all the time and effort they have devoted to the fun center. They also have as much money as I do in the fun center. All the money we have put into the fun center was not for any payables...**

The company ceased doing business in late 2002. Exhibits 30, 31, and 32 as well as the 2002 corporate income tax return (Exh. 29) established that as of December 31, 2002, the relative equities of the shareholders was roughly equal to their 45-55 percent share holdings. Saviano confirmed in his trial testimony that his assertion that the Praters "have as much money as I do in the Fun Center" was based upon his belief that "they had as much equity or capital as I had", RP 66, and that he considered their foregone wages as part of their capital contribution to the corporation. RP 67.

The parties held an annual meeting of shareholders on April 14, 2003. Exhibit 14 is the minutes of that meeting. During that meeting, Dennis Saviano agreed that wages were due to the Praters, but contended no particular amount had been agreed to. RP 106-107. The Trial Court determined that in October 2002, the parties had contributed capital roughly equivalent to their respective stock shares of 45 and 55 percent. Finding of Fact No. 4. Saviano does not challenge these relative percentages on appeal.

From its incorporation in 1993 until the annual meeting of shareholders on April 14, 2003, Westport had two directors: Harold Prater and Dennis Saviano. Exh. 1 (Articles of Incorporation) and Exhibit 12 (Bylaws). At the April 14, 2003 Annual Meeting of Shareholders, Dennis Saviano, through his majority voting power, passed a resolution to amend the corporate bylaws to allow only one director. He then nominated and elected himself sole director. The April 14, 2003 Minutes do not mention “loans” by Saviano to the corporation, and there is no evidence in the record of any official corporate act authorizing corporate debt to Mr. Saviano.

Saviano contended that “after really October of ’02, I began making loans to the corporation.” RP 87. However, the Court rejected this contention, and found that after 2002 Saviano undertook a course of action that involved self-dealing to “further enhance his future ability to recover all of his future and past investments by executing promissory notes on behalf of the corporation...” Finding of Fact No. 8.

On April 15, 2004, Saviano prepared a “Written Consent of The Director Without a Meeting” dated April 15, 2004. (Exhibit 16) It states on page 1:

The president is authorized and directed to continue the borrowing arrangement with the Company’s majority shareholder, Dennis Saviano, to fund the Company’s continuing financial obligations. Consistent with past practice, the borrowings are to be evidenced by a promissory note(s) and secured by a lien on the Company’s assets which shall be perfected by filing with the appropriate officials.

This resolution is the first evidence of any official corporate act authorizing the corporation to incur debt from Mr. Saviano. The April 15, 2004 Minutes (Exh. 16) were enacted by Saviano without notice to the Praters. Exhibit 17 was an April 15, 2006 secured Promissory Note in the face amount of \$300,000.00. Saviano executed this note in an attempt to make himself a creditor of the corporation for the \$300,000.00 face amount. Saviano admitted in his trial testimony that the figure was an approximation of money he believed he had paid for the benefit of the corporation. RP 74. He filed UCC-1 financing statement to attempt to make the debt a secured obligation against the corporation’s assets.

The Trial Court concluded, using Saviano’s own accounting summaries (Exh. 1, pp. 327-30; CP 119-122) that he had advanced his own funds in the amount of \$179,108.00 for calendar years 2003 through 2006 “to preserve the assets of the corporation and further preserve personal assets of the parties”. The Praters do not challenge this. The Court concluded that Saviano “was thus entitled to be reimbursed for

those sums similar to what a receiver would have been allowed to arrive at the situation we are with the corporation's assets being sold and proceeds to be received." Conclusion of Law No. 3.C.

The Court concluded that the Promissory Notes and other corporate actions making Saviano a secured creditor of the corporation were unenforceable and shall not be paid. Conclusion of Law 3.B.

On July 14, 2006, Dennis Saviano filed the present lawsuit seeking to dissolve Westport, with liquidation and distribution of the assets. The Praters agreed that the corporation should be dissolved and the assets distributed. In 2006, the assets of Westport were sold, (Exhibits 5, 8, 9, and 20), which will result in the payment of \$350,000.00 to the corporation. Finding of Fact No. 12. Per Agreed Order, all proceeds from the sale are to be deposited into the registry of the court. The purpose of trial was to determine the relative claims of the parties to the proceeds of the sale, including Saviano's alleged lien priority claims.

III. ARGUMENT.

A. Standard of Review.

When findings of fact and conclusions of law are entered following a bench trial, appellate review is limited to determining whether the findings are supported by substantial evidence, and if so, whether the findings support the trial court's conclusions of law and judgment. *Holland v. Boeing Co.*, 90 Wn.2d 384, 390-91, 583 P.2d 621 (1978). Evidence is substantial if it is sufficient to persuade a fair-minded person that the declared premise is true. *Nguyen v. Dep't of Health, Med. Quality Assurance Comm'n*, 144 Wn.2d 51, 536, 29 P.3d 689 (2001), *cert denied*, 535 U.S. 904, 122 S.Ct. 1203, 152 L.Ed.2d 141 (2002).

Sunnyside Valley Irr. Dist. v. Dickie, 111 Wn. App. 209, 214, 43 P.2d 1277 (2002), *J. Aff'd*, 149 Wn.2d 873, 73 P.3d 369 (2003). The challenging party bears the burden of showing that the findings are not supported by the record. *Id.*; *Standing Rock Homeowner's Ass'n v. Misich*, 106 Wn. App. 231, 243, 23 P.3d 520 (2001), *rev. den.*, 145 Wn.2d 1008, 37 P.3d 290 (2001).

B. The Trial Court correctly found the April 16, 2006 Promissory Note unenforceable as being executed through self-dealing in breach of Saviano's fiduciary duties to the other shareholders.

By Saviano's own testimony, the \$300,000.00 face value of the promissory note is no more than an approximation. The evidence proved that Saviano paid \$179,108.00 on behalf of the corporation for the calendar years 2003 through 2006. Appellant makes the argument that the \$179,108.00 figure is not accurate because it did not include \$122,699.78 in 2002 "to pay the deferred payables owing". Saviano failed to make this argument to the Trial Court, and may not make it for the first time on appeal. Appellate courts do not consider issues raised for the first time on review. RAP 2.5(a); *State v. Scott*, 110 Wn.2d 682, 685, 757 P.2d 492 (1988). Even if he had preserved his argument, it is refuted by Saviano's representation to the Port of Grays Harbor County that "[a]ll the money we have put into the Fun Center was not for any payables." Exh. 2 p.49.

Prior to electing himself sole director on April 14, 2003, Saviano would have not have had power to unilaterally incur corporate debt. A corporation may perform corporate acts only in the manner pointed out by

an applicable statute or controlling principles of law.¹ All corporate powers must be exercised through its Board of Directors,² which exercises its power by voting through resolutions in accordance with the corporation's Bylaws. Prior to the April 14, 2003 shareholder's meeting, Westport had two directors, and the company's incursion of debt to the majority shareholder would have required approval by a quorum of directors in accordance with the company's Bylaws. This did not occur.

Neither Saviano's accounting nor corporate resolutions supported a debt figure of \$300,000.00. Logically, since the evidence did support Saviano's payment of no more than \$179,108.00 for 2003 through 2006, the Court correctly exercised its discretion in finding that the promissory note constituted an illegal attempt to convert Saviano's pre-2003 equity contributions to secured debt, thereby diluting the equity of the minority shareholders, the Praters. The Trial Court correctly characterized this as self-dealing, and held that the \$300,000.00 promissory note was not enforceable.

C. Substantial evidence supports the Trial Court's finding that Saviano's actions on behalf of the corporation and personally were conflicting, resulting in self-dealing.

In his brief, Saviano fails to address the issue of dilution of the minority shareholders' interests, instead relying on *Interlake Porsche & Audi, Inc. v. Bucholz*, 45 Wn. App. 502, 728 P.2d 597 (1987), *rev. den.*, 107 Wn.2d 1022, 1987 WL 503121 (1987), to give an overly narrow

¹ 19 CJS *Corporations*, Sec. 556.

² RCW 23B.08.010(2); *Beall v. Pacific Nat. Bank of Seattle*, 55 Wn.2d 210, 347 P.2d 550 (1959).

definition of “self dealing.” He argues that since his actions in advancing funds benefited the corporation, there was no self-dealing. This argument misses the point. The *Interlake* majority shareholder’s personal use of corporate funds and retention of profits from a corporate business opportunity certainly amounted to a breach of fiduciary duty, entitling the corporation to damages in a derivative suit. However, the nature of Saviano’s breach of fiduciary duty is not that he damaged the corporation, but rather that he breached his fiduciary duty by engaging in a self-dealing debt restructuring scheme which had the effect of diluting the value of the interests of the minority shareholders, Praters.

The scope of Saviano’s fiduciary duties in this instance was broader than simply to avoid damage to the corporation. A director’s fiduciary duty includes not only an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage. In short, directors must avoid any conflict between duty and self-interest. *Ivanhoe Partners*, 535 A.2d 1334, 1335 (Del. 1987), citing *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); and *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. Sup. 1983). A shareholder owes a fiduciary duty if he owns a majority interest in or exercises control over the business affairs of the corporation. *Ivanhoe Partners*, 535 A.2d at 1334; *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (1985). See also, *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006) (Minority shareholders had direct breach of fiduciary duty claim against CEO/controlling shareholder for

approving transaction in which CEO forgave corporation's debt to him in exchange for overvalued stock that diluted the interests of minority shareholders).

There is a clear distinction between capital contributions by Saviano made during a time when the company had two directors and "loans" he may have authorized in self-dealing with the corporation as a sole director. Prior to Saviano's election as the sole director on April 14, 2003, the Praters would have had notice of what Saviano was trying to do, and would have had the opportunity to protect from dilution their more than \$300,000.00 capital investment. Once Saviano elected himself as sole director, he owed the minority shareholders a fiduciary duty to protect their investment, and not deliberately keep them in the dark while transferring all their equity to himself. It was illegal under the circumstances for Mr. Saviano, possessing a clear conflict of interest, to dilute the minority shareholders' interests to zero by unilaterally recharacterizing all of the company equity as secured debt to himself. Generally, contracts that are illegal or flow from illegal acts are unenforceable. *Evans v. Luster*, 84 Wn. App. 447, 450, 92 P.2d 455 (1996).

In summary, substantial evidence supports the Trial Court's finding that the \$300,000.00 promissory note amounted to unenforceable as an illegal dilution of the Praters' equity.

D. The Trial Court correctly characterized Saviano's role in advancing funds as that of a "quasi receiver".

The trial court correctly awarded Saviano a direct claim against the net proceeds of the asset sales for \$179,108.00 he advanced for the corporation's benefit after 2002. This is consistent with the fact that his payments benefited the corporation and the interests of all shareholders until a buyer for the assets could be found. Thus, the Trial Court correctly characterized Saviano's role as that of "quasi-receiver."

A formal receivership was not necessarily for the trial court to treat Saviano as a "quasi-receiver". Although no Washington cases directly deal with the issue, there is support from other jurisdictions for the approach that the Trial Court took in the present case. For example, in *Patel v. Patel*, 627 S.E.2d 21 (Ga. 2006), the Court refused to appoint a receiver for a franchise restaurant at the request of a plaintiff who sued for fraud, conversion and injunction in connection with his allegations that he had an equitable ownership in the restaurant. *Id.*, 627 S.E.3d at 22. The Supreme Court of Georgia upheld the trial court's denial of the appointment of a receiver, holding that the fact that the defendant in possession of the business was solvent made it appropriate to treat the defendant as a quasi-receiver:

A receivership is not intended to be better than an action of ejectment or trover, and to take property from a defendant claiming title and right of possession. Where such defendant is himself solvent and there is no reason to doubt that he will be able to answer the final decree in the case, and there are no other special circumstances requiring the interposition of the extraordinary remedies, his solvency makes the court treat him as a quasi

receiver, the property being regarded as in safe hands. [Citation omitted.] In such circumstances, appointment of a receiver to take possession of the property and collect the rents or profits therefrom is not necessary to protect the parties at interest. *Liddell v. Johnson*, 213 Ga. 752, 755(1), 101 S.E.2d 755 (1958). The mere fact that Appellees are treating the restaurant as their own, without a showing of insolvency, waste, mismanagement, or other danger of loss or injury, does not furnish cause for the appointment of a receiver. *Frankel v. Frankel*, 212 Ga. 643, 644(2), 94 S.E.2d 728 (1956); *Astin v. Carden*, 194 Ga. 758, 766-767(3), 22 S.E.2d 481 (1942).

Id., 627 S.E.2d at 23. *See also, Huggins v. Huggins*, 43 S.E. 759 (Ga. 1903) (surviving partner continuing business beyond time for preparing final account for administrator of decedent treated as a “quasi-receiver” unless in solvency, waste, or danger of probable loss makes other relief necessary). *See also, In Re Stewart*, 179 F. 222 (6th Cir. 1910) where it was held that an assignee for the benefit of creditors who retained possession of property for some years after the filing of a petition in bankruptcy against his assignor, and until final adjudication and the appointment of trustee (no receiver having been appointed) might be treated in the settlement of his accounts as a quasi-receiver, and allowed compensation for such services and disbursements as benefited the estate.

The Court’s determination that the \$300,000.00 promissory note was illegal and unenforceable was a legal determination. Beyond that, it was certainly within the court’s equitable jurisdiction and discretion to characterize Saviano as a “quasi receiver” and to fashion the remedy that it did. This Court may affirm the Trial Court on any correct ground, even one that the Trial Court did not consider. *Naste v. Michels*, 107 Wn.2d

300, 308, 730 P.2d 54 (1986). One such ground is the equitable theory of unjust enrichment. The elements that must be established to prove a claim for unjust enrichment are (1) a benefit conferred by one party on the other; (2) an appreciation or knowledge by the party who receives the benefit; and (3) the acceptance or retention by the recipient of the benefit under such circumstances as make it inequitable for the defendant to retain the benefit. *Dailie Communications, Ltd. v. Trend Bus. Sys., Inc.*, 61 Wn. App. 151, 159-60, 810 P.2d 12 (1991), *rev. den.*, 117 Wn.2d 1029, 820 P.2d 511 (1991). A claim for unjust enrichment is a quasi-contractual claim. Quantum merruit – “a reasonable amount for the work done” – is the measure of recovery. *Auburn Mechanical, Inc. v. Lydig Const., Inc.*, 89 Wn. App. 893, 901, 951 P.2d 311 (1998), *rev. den.*, 136 Wn.2d 1009, 966 P.2d 902 (1998).

The Trial Court’s decision to treat Saviano as a “quasi receiver”, entitled to reimbursement for the expenses incurred in preserving the equity of the shareholders before distribution to them of the net assets, prevented unjust enrichment on the part of the Praters and corporation, and reflected a proper exercise of the court’s discretion, whether one characterizes the relief as legal or equitable. The result is logical and fair, rewarding Saviano for his protection of the mutual interests of the shareholders, while at the same time not allowing him to claim an unfair advantage by virtue of his power as the majority shareholder in control of the company’s management.

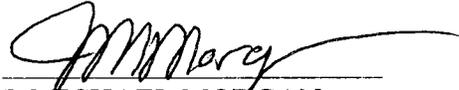
IV. CONCLUSION.

The Trial Court correctly exercised its discretion in determining that Saviano advanced \$179,108.00 of his own funds for the benefit of the corporation for calendar years 2003 through 2006. Substantial evidence in the form of Saviano's own accounting summaries supports this finding. Substantial evidence does not support the \$300,000.00 face amount of the promissory note. By definition, all Saviano's contribution in excess of \$179,108.00 were capital contributions. Therefore, to the extent that Saviano attempted to convert amounts over and above \$179,108.00 into secured debt in favor himself, such could only have been accomplished through the erosion of the minority shareholders' equity. The Trial Court correctly characterized this as "self-dealing" and found the \$300,000.00 note unenforceable.

The Trial Court correctly characterized Mr. Saviano's role in advancing money to pay the ongoing obligations of the corporation as that of "quasi receiver". This result correctly rewarded Saviano for the costs he expended for the mutual interest of all shareholders, while at the same time preventing him from unfairly converting the Prater's equity into preferred debt in favor of himself.

The decision of the Trial Court should be affirmed.

DATED this 18th day of September, 2007.



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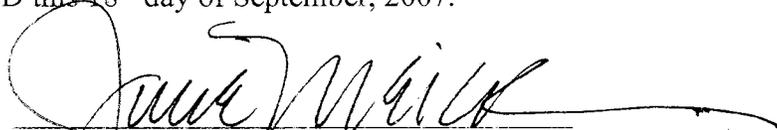
On 09/18/07 I served a complete and true copy of the original of this document by depositing a copy of same into the mails of the United States, postage prepaid addressed as follows:

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

DATED this 18th day of September, 2007.



Julie A. Meier

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STATE OF WASHINGTON
BY DEPUTY
COURT OF APPEALS
DIVISION II