

NO. 37541-9-II

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

MATTHEW SMITH COMPANY, INC.,

Plaintiffs/Respondents

vs.

DONALD C. CHILL,

Defendant/Appellant

APPEAL FROM THE SUPERIOR COURT

THE HONORABLE ROGER A. BENNETT

BRIEF OF APPELLANT

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ASSIGNMENT OF ERRORS AND ISSUES PRESENTED

ASSIGNMENT OF ERROR NO. 1: The trial court erred by confirming the arbitration award.

ASSIGNMENT OF ERROR NO. 2: The trial court erred by denying the Motion for Reconsideration.

Issues Presented:

1. Did the parties agree to arbitrate disputes concerning contracts between them when those contracts contained no provision allowing for arbitration?

2. In its Arbitration Demand, did Matthew Smith Company give adequate notice of its intention to affect other agreements between the parties?

3. Did Matthew Smith Company waive arbitration as to the \$1 million promissory note, the Executive Employment Agreement, and the agreement concerning accounts receivable?

4. Did the arbitrators have authority to determine arbitrability?

5. Should the trial court have gone beyond the terms of the Stock Purchase Agreement to determine whether the arbitrators had exceeded their powers?

ASSIGNMENT OF ERROR NO. 3: The trial court erred by granting judgment before all claims between the parties were resolved.

ASSIGNMENT OF ERROR NO. 4: The trial court erred by entering Finding of Fact No. 1 in its Findings And Conclusions on Entry of Judgment without Delay.

ASSIGNMENT OF ERROR NO. 5: The trial court erred by entering Finding of Fact No. 4 in its Findings And Conclusions on Entry of Judgment without Delay.

Issues Presented:

1. Were the Findings of Fact supported by substantial evidence?
2. To the extent that the Findings of Fact were mixed Findings of Fact and Conclusions of Law, did the trial court err in making them?
3. Did the trial court abuse its discretion in granting judgment?

ASSIGNMENT OF ERROR NO. 6: The trial court erred in granting a writ of attachment as to community real property.

Issues Presented:

1. Does the alleged obligation from Mr. Chill to Matthew Smith Company arise out of the management of separate property?

2. Is Mr. Chill's alleged obligation to Matthew Smith Company a tort?

STATEMENT OF THE CASE

I. General Background.

Charles Prescott Restoration Co. is a Washington corporation involved in disaster restoration work. It was formed in October of 1993. Donald Chill was its sole shareholder prior to 2007. (CP 164)

Mr. Chill married Abigail Chill on November 16, 2001. By that time, he had acquired all the stock in Charles Prescott Restoration Co. that he would ever have. (CP 164)

II. Sale of Stock.

In 2005, Mr. Chill became interested in selling the business for family and personal reasons, including the fact that he is a cancer survivor. In late May 2006, Mr. Chill was referred to Jeff Kraai, a business broker with Exit Strategies, Inc., in Vancouver. (CP 220, 259)

At that time, Matthew Smith was working in middle management in the semi-conductor industry. He had lived and worked in Camas, Washington, but had moved to Texas. By 2004, he decided to go into business for himself. He contacted Mr. Kraai to discuss purchasing a

Service Master business in Tigard, Oregon. He ultimately chose not purchase that business. (CP 218, 228)

Mr. Kraai and Mr. Smith remained in touch with each other. In the summer of 2006, Mr. Kraai contacted Mr. Smith by e-mail to inform him about businesses then for sale. One of these was Charles Prescott Restoration Co. Mr. Kraai told Mr. Smith that it would be the “best one for him.” Mr. Smith responded by indicating that he wanted to pursue purchasing that business “with all vigor.” (CP 241-5)

During their communications, Mr. Smith made it clear to Mr. Kraai that he only had a limited amount of money to put down on the purchase. Mr. Kraai believed that Mr. Smith could finance the purchase through a loan guaranteed by the Small Business Administration. (CP 221, 229)

Mr. Smith executed a Non Disclosure Agreement to secure information about the company. Mr. Smith was apparently impressed by the information he received. It was agreed that he would come to southwest Washington, meet with Mr. Chill, and inspect the business on November 13-14, 2006. (CP 224, 246)

After he arrived in the Portland area, Mr. Smith first met with Edwin Randall, a representative of Wachovia Small Business Capital (Wachovia), on November 13, 2006. Mr. Kraai arranged and attended this meeting. The three discussed Mr. Smith’s obtaining a Small Business

Administration loan through Wachovia to finance his down payment for the purchase price. Loans of this type require a down payment of ten per cent (10%) of the purchase price. Mr. Smith indicated that he could only contribute \$400,000.00. This limited the purchase price he could pay to \$4 million. (CP 221-4, 229-30)

Mr. Smith and Mr. Chill met on November 13, 2006, and again on November 14, 2006. At 5:32 a.m. on November 15, 2006, Mr. Kraai e-mailed Mr. Chill a document purporting to be Mr. Smith's offer to purchase all stock in Charles Prescott Restoration Co. for a price of \$4 million. It envisioned a down payment totaling approximately \$2 million and promissory notes for the balance. A close reading of the document shows that the promissory note amounts were improperly calculated. (CP 326-32, 348) Marketing materials had offered to sell assets of the company. The offer, however, sought to purchase Mr. Chill's stock. Mr. Smith structured the offer in that way so that he could obtain the necessary financing. (CP 223)

Mr. Chill and Mr. Smith further negotiated terms through Mr. Kraai. On December 12-13, 2006, they executed the Counter Offer to

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Purchase and Earnest Money Agreement. (CP 247-52)¹ The agreement set out a purchase price of \$4 million for Mr. Chill's stock in the corporation with the same down payment and promissory notes for the balance. It envisioned "final definitive sales agreements that would be more comprehensive in scope." (CP 247) It also envisioned the parties' agreeing to a seven (7) year compensation package acceptable to Mr. Chill in Paragraph 3.1.19. (CP 249) This agreement contained no provision allowing for arbitration of disputes. (CP 247-52)

Mr. Kraai assisted the parties in negotiating the compensation package. He developed a proposal and relayed it to Mr. Smith first. Mr. Smith requested some revisions. (CP 274-8)

The parties ultimately entered into the Compensation Plan for Earn-Out in January of 2007. (CP 253-5) This agreement also contains no arbitration provision. It requires Mr. Smith to execute a \$1 million promissory note to Mr. Chill. It also required that Mr. Chill be hired as Chief Marketing Officer for Charles Prescott Restoration Co. and work for a minimum of 18 months. (CP 253) This agreement also contained no provision allowing for arbitration of disputes.

¹ There are some differences between Mr. Smith's initial offer and the Counter Offer to Purchase and Earnest Money Agreement. Those changes are of no significance here.

In January of 2007, Mr. Kraai provided Mr. Smith with tax returns for Charles Prescott Restoration Co. along with other financial statements and reports. (CP 279-93; 307-24)

Mr. Smith had applied to Wachovia for his Small Business Administration loan. By the end of January 2007, he had submitted a business plan. In that document, he announced that Mr. Chill would be hired as marketing officer in the document. (CP 261)

Wachovia sent Mr. Smith a letter indicating that he had been conditionally approved for financing. The letter required Mr. Smith's signature. It contained the following language:

By signing this letter, borrower (Mr. Smith) agrees not to enter into any other loan agreements prior to closing without Lender's (Wachovia's) prior consent.

(CP 256)

Mr. Kraai referred Mr. Smith to William Du Val, an attorney with Du Val Business Law in Portland, Oregon, to assist with the transaction. (CP 219-20) Mr. Du Val saw to the incorporation of Matthew Smith Company, a Washington corporation. (CP 184)

Meanwhile, Wachovia sought an appraisal of the business by Gulf Coast Financial. Mr. Smith claimed that he relied heavily on that appraisal to determine whether he should consummate the purchase. On March 21,

2007, Mr. Randall advised Mr. Smith that Gulf Coast Financial had set the company's value at \$4,063,000.00, or slightly above the agreed purchase price for the stock. (CP 231, 325)

Any prospective buyer of a business must carefully investigate that business to make sure that the purchase is advisable. Mr. Smith specifically agreed to conduct such an evaluation in the Non Disclosure Agreement. Nonetheless, and in April of 2007, Mr. Du Val questioned the sufficiency of Mr. Smith's investigation. (CP 271)

In early 2007, Marguerite Storbo was a Canadian lawyer who had moved to the Portland Metropolitan area and was planning to take the Oregon Bar examination. She was working with Du Val Business Law. Mr. Du Val assigned her to assist Mr. Smith with the transaction. (CP 185)

The transaction closed on May 23, 2007, at Pacific Northwest Title in Clackamas, Oregon. A great many documents were signed at that meeting. These included the following:

1. A Stock Purchase Agreement providing for the purchase of Mr. Chill's stock in Charles Prescott Restoration Co. by Matthew Smith Company. It set a purchase price for the stock of \$4 million. Of that sum, \$2.2 million would be paid down, and balance would be paid in two promissory notes totaling \$1.8 million. (CP 20-54)
2. A Loan Agreement between Mr. Smith and Wachovia. It provided in pertinent part:

Borrower (Matthew Smith Company). . . agree that Borrower. . . shall not, without the prior consent of Lender: (1) create, incur or assume indebtedness for borrowed money, including capital leases, except for trade debt incurred in the normal course of business and indebtedness to Lender contemplated by this agreement . . .(CP 349-50)

3. An Executive Employment Agreement providing for Mr. Chill's employment with Charles Prescott Restoration. Matthew Smith Company was not a party to this agreement. (CP 185)

4. A promissory note to Wachovia for its loan. The sum advanced included \$1.8 million of the down payment together with sums for working capital. (CP 185)

5. The promissory notes envisioned by the Stock Purchase Agreement. Each of these notes contained "Standby Provisions" that precluded Mr. Smith from collecting on the notes until Wachovia had been repaid in full. (CP 411-18)

6. A commercial lease by which Charles Prescott Restoration Co. and Matthew Smith Company would lease real property Mr. Chill was buying on contract for the operation of the business. (CP 398-410)

After these items and others were signed, the closing officer left the parties. Ms. Storbo and Mr. Randall also departed. Mr. Smith then executed the \$1 million promissory note envisioned by the Compensation Plan for Earn-Out Agreement. Mr. Chill and Mr. Smith then executed a document giving Mr. Chill the right to all accounts receivable of Charles Prescott Restoration that remained outstanding as of the date of closing,

May 23, 2007. (CP 18-19, 226, 236, 272-73) According to Mr. Kraai, the parties had agreed to the latter arrangement. They had also agreed that Mr. Chill would be entitled to all the company's retained earnings. (CP 225-26)

There is no evidence that Mr. Smith ever informed Wachovia of his intention to execute the \$1 million promissory note prior to closing.

III. Further Events.

During the week after closing, Mr. Smith met with Patricia Johanson, the company's bookkeeper. He wanted to know the amounts of the company's regular payroll and the level of accounts payable. There is no evidence that Mr. Chill had discussed these subjects with Mr. Smith or that Mr. Smith had ever asked him. Ms. Johanson perceived that she was giving Mr. Smith new information that he was shocked to learn. (CP 238-39)

Mr. Smith then requested a meeting at the Red Lion Inn in Kelso, Washington. Mr. Smith and Mr. Chill were both present at the meeting along with Ms. Johanson and Roy McMaster, the company's tax preparer. The group discussed the fact that Mr. Chill had received the accounts receivable and the retained earnings. Mr. McMaster encouraged Mr. Chill to give back some of the retained earnings he had received. (CP 239-40)

According to Mr. Smith, the group was concerned that the company would shortly be insolvent. (CP 90)

Mr. Smith then contacted Mr. Du Val and engaged his firm to represent Matthew Smith Company in litigation against Mr. Chill. (CP 187) By June 18, 2007, Mr. Smith had removed \$90,000.00 from the bank account of Charles Prescott Restoration Co. to pay attorneys fees to Du Val Business Law for this litigation and for representation in connection with the transaction. On the same day, he removed \$120,000.00 from the company's account for his own benefit. These withdrawals reduced the company's bank balance from \$329,488.85 on June 15, 2007, to \$132,528.36. (CP 333, 351-54)

Through counsel, Mr. Smith demanded rescission on June 20, 2007. (CP 188) Nonetheless, he continued to operate the company and to pay himself a salary to do so. (CP 188) On July 6, 2007, he fired Mr. Chill from the post of Chief Marketing Officer. (CP 233) Thereafter, he did no marketing of the business although marketing was critical to its continued viability. (CP 232-33, 263) In the latter part of August, Mr. Smith ordered the company not to accept any new work. (CP 234)

Mr. Smith laid off all employees in early September except for Ms. Johanson and Dave Kelln, a superintendent. The company defaulted on its rent to Mr. Chill in September of 2007, and ultimately vacated the

premises. (CP 188) It also ceased making sales tax payments after July of 2007. (CP 189)

From the date of closing to the end of 2007, Charles Prescott Restoration Co. received over \$440,000.00 in receivables that were earmarked for Mr. Chill by the agreement signed at closing. None of these were paid over to Mr. Chill. (CP 189, 272-73, 469-71)

IV. The Arbitration.

Counsel for Matthew Smith Company prepared and sent an Arbitration Demand on June 28, 2007. It stated two claims. These were “fraud in the inducement” and violation of certain provisions of the Stock Purchase Agreement. It sought rescission of the Stock Purchase Agreement and damages for violations its terms. It contained no reference to the \$1 million promissory note; the Commercial Lease; the Executive Employment Agreement; or the agreement concerning accounts receivable. (CP 140) Counsel for Mr. Chill agreed to accept service of the document. (CP 364)

At the same time, counsel for Matthew Smith Company recognized that there were claims between the parties not subject to arbitration. He asked for an agreement to arbitrate those claims as well. (CP 364) Counsel for Mr. Chill declined that offer and suggested that the parties

forego arbitration in favor of a court proceeding that would deal with all claims. He also indicated his intention to file suit on Mr. Chill's behalf for collection of the \$1 million promissory note and for breach of the Executive Employment Agreement. Counsel for Matthew Smith Company would not waive arbitration of the claim for rescission. He also stated that he would present the claims his client could not arbitrate in the court action to be filed. (CP 16-17)

Mr. Chill filed suit in Clark County Superior Court on July 9, 2007. As relevant here, the claim sought damages for failure to pay on the \$1 million promissory note; breach of the Executive Employment Agreement; and claims relating to the agreement concerning accounts receivable. (CP 716-19) Matthew Smith Company ultimately answered and set out certain counterclaims. (CP 720-31) It did not move to stay the suit Mr. Chill filed pending arbitration. (CP 190)

The parties ultimately chose a panel of three arbitrators. The panel scheduled the arbitration hearing for December 3, 2007. The hearing lasted four days and concluded on December 6, 2007. (CP 196)

During the course of the hearing, the arbitrators were made aware of the Executive Employment Agreement, the Commercial Lease, and the document Mr. Chill and Mr. Smith had signed concerning accounts receivable. No party made any claim on any of them. (CP 195)

The parties also discussed the \$1 million promissory note. Matthew Smith Company had made a claim based on common law fraud and also under the Washington State Securities Act, RCW 21.20. Mr. Chill argued that reliance was absent under both theories. He noted that Mr. Smith had contracted to perform his own due diligence investigation in the Nondisclosure Agreement and pointed out ways that his investigation was woefully deficient. He referred to testimony given by Mr. Smith that he had “heavily relied” on the Gulf Coast Financial appraisal to determine whether he should consummate the transaction. He then pointed out that Mr. Smith should have reciprocated by informing Wachovia of the \$1 million note. He stated that Mr. Smith had obligated himself to two distinct types of debt—the stock purchase price of \$4 million and the \$1 million promissory note—and that the Gulf Coast Financial appraisal was less than the total. Mr. Chill argued that Mr. Smith’s failure to advise Wachovia of the \$1 million promissory note amounted to a violation of 15 U.S.C. 1645(a), a criminal statute precluding fraud in Small Business Administration loans. From that factor, he urged the arbitrators to deny common law rescission on the basis of unclean hands and to deny relief under RCW 21.20 on the basis of *pari delicto*. (CP 419-25)

On the last day of the arbitration, the arbitrators orally concluded that Matthew Smith Company was entitled to relief under RCW 21.20. It was then agreed that one of their number, James D. Ladley, would deal with further proceedings and execute the final award. (CP 196)

For the first time, and on January 8, 2008, Matthew Smith Company asked that the final award include cancellation or rescission of agreements or contracts other than the Stock Purchase Agreement. (CP 196) Arbitrator Ladley ultimately signed the award on January 27, 2008. It purported to cancel the \$1 million note and all other contracts entered into between the parties in connection with the Stock Purchase Agreement. The award specifically does not foreclose jurisdictional challenges to these orders. (CP 8-10)

V. Court Proceedings.

On January 29, 2008, Mathew Smith Company moved to confirm the arbitration award. (CP 1-3) Mr. Chill then moved to modify or vacate the award. (CP 55-6) The trial court entered its ruling granting confirmation and denying modification. (CP 676-7) Mr. Chill moved for reconsideration. (CP 697-8) The trial court denied this motion. (CP 704) On March 14, 2008, it confirmed the arbitration award. (CP 699-700)

Matthew Smith Company sought judgment on less than all claims. The trial court entered certain findings in connection with the requirement that there be no just reason for delay in entry of the final judgment. The content of these findings will be discussed below. It then granted judgment to Matthew Smith Company on less than all claims. (CP 705-9)

While the matter was pending, Matthew Smith Company sought to attach real property owned by Mr. and Mrs. Chill in Clark and Cowlitz Counties. All but one of these parcels had been acquired after the couple's marriage. (CP 96-102) Nonetheless, Matthew Smith Company did not join Abigail Chill as a party or give her notice of the proceedings and an opportunity to be heard. Mr. Chill had purchased the fifth parcel with Jeffrey Rauth on a real estate contract. Without showing that Mr. Rauth had conveyed away his interest in that parcel, Matthew Smith Company did not join him or give him notice of its attempt to attach the fifth parcel. (CP 98-99)

The trial court granted the writ of attachment. It allowed only Mr. Chill's undivided one-half interest in the parcels acquired marriage to be attached. (CP 679-82) The writ Matthew Smith Company obtained, however, did not contain that limitation. (CP 614-16; CP 689-92) The Cowlitz County sheriff levied the writ of the parcels in that county on March 3, 2008. (CP 683-92).

Mr. Chill appealed on March 31, 2008.

ARGUMENT

ASSIGNMENT OF ERROR NO. 1: The trial court erred by confirming the arbitration award.

ASSIGNMENT OF ERROR NO. 2: The trial court erred by denying the Motion for Reconsideration.

I. Introduction.

The arbitration award cancels the Stock Purchase Agreement and the notes mentioned in that agreement. It also purports to cancel the \$1 million promissory note and other contracts entered into between the parties. The arbitration panel had no authority to cancel the \$1 million promissory note and the other contracts because the parties did not agree to arbitrate claims relating to those agreements. Furthermore, the note and the other agreements were not mentioned in the arbitration demand. Finally, Matthew Smith Company waived rights to arbitrate claims connected to the note and the other agreements. The trial court erred by not modifying the arbitration award to exclude any reference to the other agreements and the \$1 million promissory note.

II. Scope of Review.

Arbitration awards are subject to modification on the grounds that the arbitrator has made an award on a matter not submitted for arbitration. RCW 7.04A.240(1)(b). The question presented is, therefore, whether the parties agreed to arbitrate a given dispute. The court must decide this issue based on the language of the parties' agreement. It is a question of law that the Court of Appeals reviews *de novo*. *Tacoma Narrows Constructors v. Nippon Steel-Kawada Bridge, Inc.*, 138 Wn.App. 203,213, 156 P.3d 293 (2007).

III. The Parties Did Not Agree to Arbitrate Disputes Concerning the \$1 Million Promissory Note, the Executive Employment Agreement, the Commercial Lease, or the Agreement Concerning Accounts Receivable.

A party cannot be forced to arbitrate a dispute unless that party has agreed to do so. The Court must carefully review the language of the arbitration clause within the agreement to determine whether it requires arbitration of a given dispute. If the dispute in question does not fall within the range of the matters that the parties have agreed to arbitrate, the arbitrators can make no award on the dispute. *Greenlee v. AACON Transport Auto, Inc.*, 6 Wn.App. 742, 496 P.2d 359 (1972); *ACF Property Management Inc., v. Chaussee*, 69 Wn.App. 913, 850 P.2d 1387 (1993); *Tacoma Narrows Constructors v. Nippon Steel-Kawada Bridge, Inc.*,

supra; *Nelson v. Westport Shipyard, Inc.*, 140 Wn.App. 102, 163 P.3d 807 (2007).

There is no arbitration provision in the \$1 million promissory note, the Executive Employment Agreement, the Commercial Lease, or the agreement signed by Mr. Smith and Mr. Chill concerning accounts receivable. For that reason, the arbitrators were powerless to rule on any matters related to those agreements.

This Court dealt with a similarly worded arbitration clause in *Nelson v. Westport Shipyard, Inc.*, *supra*. Mr. Nelson, one of the shareholders of Westport Shipyard, Inc., sued after his employment was terminated and raised a number of claims. These included breach of the employment contract; disability discrimination; oppression of a minority shareholder; tortious interference with a business expectancy; failure to pay wages; and invalidation of the shareholder's agreement. The parties had entered into a Shareholders Agreement that contained an arbitration clause requiring arbitration of "any disputes among the shareholders arising out of this agreement." The corporation and other shareholders sought to refer the entire matter to arbitration. The trial court denied the motion. The Court of Appeals affirmed because the arbitration clause did not allow for arbitration of the claims that Mr. Nelson was making. It excepted from this ruling an issue involving the amount to be paid for Mr.

Nelson's stock under the terms of the shareholder's agreement because it "arose" out of that agreement.

The Stock Purchase Agreement does contain an arbitration clause in Section 19.15(a). It reads in pertinent part:

...any controversy or claim arising out of this Agreement will be settled by arbitration in the City of Vancouver, Clark County, Washington.

(CP 48; emphasis added) By no stretch, do issues relating to the \$1 million promissory note, the Commercial Lease, the Executive Employment Agreement, and the agreement regarding accounts receivable "arise out of the subject matter of" the Stock Purchase Agreement. None of them are mentioned within its terms.

The Stock Purchase Agreement also contains an integration clause in Section 19.17. It provides as follows:

This agreement contains the entire understanding of the parties regarding the subject matter of this Agreement and supersedes all prior and contemporaneous negotiations and agreements, whether written or oral, between the parties with respect to the subject matter of this Agreement.

(CP 49; emphasis added) This language is different than most integration clauses because it is limited. It does not say, as many such clauses do, that there are no other agreements between the parties. Rather, its terms recognize that there may well be other understandings that the parties

have. And, as we know, there indeed were other agreements. Since the Stock Purchase Agreement must be read as a whole, Section 19.17 must be read in conjunction with Section 19.15(a). *Dice v. City of Montesano*, 131 Wn.App. 675, 128 P.3d 1253 (2006). When that is done, it is clear that the parties intended to limit arbitration to claims based on the terms of the Stock Purchase Agreement or purchase of the stock and nothing else.

The parties could have used the phrase “arising out of or relating to this Agreement” in Section 19.15(a). That phrase is common in arbitration agreements. See, e.g., *Teufel Construction Co. v. American Arbitration Association*, 3 Wn.App. 24, 25, 472 P.2d 572 (1970); *Dunlap v. Wild*, 22 Wn.App. 583,585, 591 P.2d 834 (1979); *Keen v. I.F.G. Leasing*, 28 Wn.App. 167, 169, 765 P.2d 1329 (1980); *Kinsey v. Bradley*, 53 Wn.App. 167, 168, 7656 P.2d 1329 (1989); *McClure v. Tremaine*, 77 Wn.App. 312, 313, 890 P.2d 466 (1995). That phrase is perceived to be much broader than “arising out of” or “arising hereunder.” *Nelson v. Westport Shipyard, Inc., supra*, 140 Wn.App. at 113.

The federal courts have also noted that that the phrase “arising out of or related to this agreement” is a standard term and is broader than the phrase “arising out of this agreement.” *Mediterranean Enterprises, Inc., v. Ssangyong Corp*, 708 F.2d 1458, 1463 (9th Cir. 1983). The use of the narrower phrase means that the parties did want to submit each and every

aspect of their business relationship to arbitration. *Bell Canada v. ITT Telecommunications Corp*, 563 F.Supp. 636, 639 (S.D.N.Y. 1983); *Beckham v. William Bailey Co.*, 655 F.Supp. 288, 291 (N.D.Tex. 1987).

The case conceptually closest to ours is *Tracer Research Corp. v. National Environmental Services Company*, 42 F.3d 1292 (9th Cir. 1994). The parties had entered in to a licensing agreement containing an arbitration clause providing for arbitration for controversies “arising out of” the agreement. Tracer Research sued raising a number of tort claims including misappropriation of trade secrets. The Court granted a preliminary injunction and then referred the entire matter to arbitration. The arbitrators found against Tracer Research on its trade secret misappropriation claim. The Court then dissolved the preliminary injunction based on the arbitration award. The Court of Appeals reversed. It noted that the arbitration agreement’s failure to use “arising out of or related to” limited its scope and meant that the trade secrets claim was not subject to arbitration. It remanded and requested the trial court to review independently the propriety of the preliminary injunction.

As indicated, the precise language of the arbitration clause is limited. It is phrased as “arising out of” the subject matter of the agreement as opposed to “arising out of or related to” the subject matter of the agreement. It discloses an intention not to arbitrate all matters

between the parties. It will therefore not support an arbitration award concerning the \$1 million promissory note; the Commercial Lease; the Executive Employment Agreement; or the agreement concerning accounts receivable.

IV. Matthew Smith Company Did Not Give Adequate Notice of Its Intention to Affect the Other Agreements.

Any person who initiates arbitration proceedings must give notice to the other party. That notice must describe the nature of the controversy and the remedy sought. RCW 7.04A.090. Any arbitration conducted without proper notice as set out in RCW 7.04A.090 so as to prejudice the rights of the adverse so as to prejudice the rights of the other party is subject to vacation. RCW 7.04A.230(1)(f).

In this case, the Arbitration Demand submitted by Matthew Smith Company contained no reference to the \$1 million promissory note; the Executive Employment Agreement; the Commercial Lease; or the agreement concerning accounts receivable. It sought rescission of the Stock Purchase Agreement and damages for its breach. Mr. Chill did not learn until over one month after the conclusion of the arbitration hearing that Matthew Smith Company wanted to affect the other agreements.

Matthew Smith Company sent the Arbitration Demand on June 28, 2007. At that time, it was current on its rent to Mr. Chill. There was no

claim existing at that time based on the Commercial Lease. The default occurred in September of 2007. Clearly, Matthew Smith Company could not give notice of a claim that did not yet exist.

Mr. Chill was prejudiced by this lack of notice. Had he known the intentions of Matthew Smith Company, he could have moved to stay arbitration of matters concerning those agreements on the basis that there was no agreement to arbitrate. RCW 7.04A.070(2)

This failure to provide adequate notice requires the vacation of the arbitration award insofar as it addresses agreements other than the Stock Purchase Agreement.

V. Matthew Smith Company Waived Arbitration of Claims Concerning the \$1 Million Promissory Note and the Executive Employment Agreement.

On July 9, 2007, Mr. Chill commenced suit against Matthew Smith Company on the promissory note; the Executive Employment Agreement; and the agreement regarding accounts receivable. Matthew Smith Company never moved to compel arbitration of those claims. Rather, it answered the complaint without mentioning any right to arbitrate and asserted counterclaims. In doing so, it waived arbitration of claims based on those agreements.

A party to an arbitration agreement may waive the right to arbitrate either implicitly or explicitly. Waiver follows from the failure to invoke an arbitration clause when the action is commenced. No prejudice need be shown to make out the waiver. *Lake Washington School District No. 414 v. Mobile Modules Northwest, Inc.* 28 Wn.App. 59, 621 P.2d 791 (1981); *Ives v. Ramsden*, 142 Wn.App. 369, 174 P.3d 1231 (2008).

It has long been settled law in Washington that a party who answers a complaint without demanding arbitration or discussing arbitration in the answer waives arbitration. *McNeff v. Capistran*, 120 Wash. 498, 208 P. 41 (1922); *Pedersen v. Klinkert*, 56 Wn.2d 313, 352 P.2d 1025 (1960). That is precisely what happened here. Mr. Chill sued on several of the agreements between the parties. Matthew Smith Company answered but did not move to stay or discuss arbitration in its answer. By doing so, it waived the right to arbitrate claims based on those agreements. On that basis, the arbitration award must be modified to eliminate any reference to the \$1 million promissory note or the other agreements.

VI. The Arbitrators Lacked Authority to Determine Arbitrability.

The arbitration award indicates that the arbitrators determined that they had jurisdiction to address the jurisdictional issues that have been presented here. The award did not foreclose, however, court review of this

issue with regard to the \$1 million promissory note. That statement does not assist Matthew Smith Company because the arbitrators had no authority to determine arbitrability.

Courts decide whether a dispute is subject to arbitration unless the parties have otherwise agreed. *Nelson v. Westport Shipyard, Inc., supra*, 140 Wn.App. at 117. The arbitration clause here does not vest the arbitrators with the power to determine their own jurisdiction. Therefore, the language concerning jurisdiction in the arbitration award is entitled to no weight.

VII. The Trial Court Erred by Determining That the Other Agreements Amounted to Consideration for the Stock and by Denying the Motion for Reconsideration.

In its Ruling on Motion to Vacate and Motion to Confirm Arbitration Award, the trial court stated that all of the various agreements between the parties were consideration for the purchase of the stock. Mr. Chill moved for reconsideration on this basis. The trial court denied Mr. Chill's motion. In making this ruling and denying reconsideration, the trial court erred.

As discussed above, its inquiry was limited to a review of the arbitration clause within the Stock Purchase Agreement to determine whether the parties had agreed arbitrate disputes in question. *Tacoma*

Narrows Constructors v. Nippon Steel-Kawada Bridge, Inc., supra; Nelson v. Westport Shipyard, Inc., supra. The arbitration clause was contained within the Stock Purchase Agreement. That was the only arbitration clause in any of the parties' agreements. The trial court should have limited its consideration to the language of the Stock Purchase Agreement to make its determination. Its failure to limit its inquiry was error.

VIII. Conclusion.

The parties did not agree to arbitrate disputes concerning the \$1 million promissory note; the Commercial Lease; the Executive Employment Agreement; or the agreement concerning accounts receivable. The Arbitration Demand made no reference to those agreements. Finally, Matthew Smith Company waived arbitration of any claim concerning the Executive Employment Agreement, the \$1 million promissory note, and the agreement concerning accounts receivable. Therefore, the arbitrators could not affect those agreements. The trial court was required to modify the award to eliminate the portions addressing those agreements. It erred by not doing so and by confirming the arbitration award.

ASSIGNMENT OF ERROR NO. 3: The trial court erred by entering Finding of Fact No. 1 in its Findings And Conclusions on Entry of Judgment without Delay.

ASSIGNMENT OF ERROR NO. 4: The trial court erred by entering Finding of Fact No. 4 in its Findings And Conclusions on Entry of Judgment without Delay.

ASSIGNMENT OF ERROR NO. 5: The trial court erred by granting judgment before all claims between the parties were resolved.

I. Introduction.

These Assignments of Error deal with related issues. They will be discussed together for that reason.

II. Scope of Review.

The appellate court reviews findings of fact to determine if they are supported by substantial evidence. Substantial evidence is defined as sufficient evidence to persuade a rational, fair-minded person of the truth of the finding. *Holland v. Boeing Company*, 90 Wn.2d 384, 390-1, 583 P.2d 621 (1978); *Hoglund v. Meeks*, 139 Wn.App. 854, 871, 170P.3d 1165 (2007).

Statements denominated as findings of fact may contain elements that are legal conclusions. Such findings are referred to as mixed findings of fact and conclusions of law. The portions that are factual will stand if supported by substantial evidence. The portions that are legal conclusions are subject to *de novo* review. *Erwin v. Cotter Health Systems*, 161 Wn.2d 676, 167 P.3d 112 (2007); *Rasmussen v. Bendotti*, 107 Wn.App. 947, 954-5, 29 P.3d 56 (2001).

The issue of law presented here is whether the trial court should have granted judgment on less than all claims as allowed by CR 54(b). While the appellate court will give some deference to the conclusion that the trial court makes, the trial court's decision that the requirements of the rule are met is not conclusive. The trial court abuses its discretion if its decision is based on untenable grounds or untenable reasons. *Nelbro Packing Company v. Baypack Fisheries, L.L.C.*, 101 Wn.App. 517, 523-25, 6 P.3d 22 (2000).

As will be shown below, some of the trial court's findings were not supported by substantial evidence. Furthermore, its decision was based on untenable grounds. Therefore, the judgment should not have been entered, and it should be reversed.

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II. The Relevant Findings.

Matthew Smith Company sought judgment on fewer than all claims. Such a judgment is proper only upon an express determination that there is no just reason for delay in entering the judgment as a final judgment supported by written findings. CR 54(b). The trial court determined that there was no just reason for delay and made its own findings. Findings 1-4 state:

1. Matthew Smith Company, Inc., and Donald Chill entered into an agreement to submit all claims arising under their Stock Purchase Agreement to binding arbitration.
2. The arbitration panel which the matter issued an award which included cancellation of all notes and contracts between the parties.
3. The court has confirmed the arbitration award in its entirety.
4. Donald Chill has filed a separate lawsuit seeking damages from Matthew Smith, Matthew Smith Company, and Charles Prescott Restoration, Inc. alleging breach of various agreements between the parties all of which have been cancelled by the arbitration award and judgment of this court.

(CP 705-6)

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IV. To the Extent That Finding of Fact No. 1 Suggests an Agreement to Arbitrate Other Than Contained in the Stock Purchase Agreement, It Is Not Supported by Substantial Evidence.

The import of Finding of Fact No. 1 is not clear. It states that the parties entered into an agreement to arbitrate. The parties did enter into the Stock Purchase Agreement. And that document does contain an arbitration clause that has been discussed in detail above.

The finding may be read, however, to suggest that there was some other arbitration agreement between the parties. Such a conclusion is obviously not supported by substantial evidence. Matthew Smith Company specifically wanted to arbitrate each and every claim pending between the parties. Mr. Chill clearly refused that request and filed suit on matters for which there was no arbitration agreement. Therefore, this finding should be read to refer only to the arbitration clause in the Stock Purchase Agreement. Any other interpretation would mean that the trial court erred in making the finding.

V. Findings of Fact Nos. 3 and 4 Are Based on Errors of Law.

Error is assigned to Finding of Fact Nos. 3 and 4 out of an abundance of caution.

Finding of Fact No. 3 states that the trial court confirmed the arbitration award. That is, of course, true. Its doing so was error, however.

Finding of Fact No. 4 correctly says that Mr. Chill filed suit on other notes and contracts and that the arbitrators ruled that these were cancelled. However, and as discussed above, the arbitrators had no power to make that decision.

These findings should be considered mixed findings of fact and conclusion of law for that reason. They appear to presume that the arbitrators had the power to make their decisions and that the trial court correctly confirmed the arbitration award. To that extent, they are subject to *de novo* review.

V. The Trial Court Abused Its Discretion in Granting the Judgment.

The trial court's finding of no just reason for delay appears to be based on that part of the arbitration award cancelling the other agreements between the parties. It noted that Mr. Chill had sued on other matters. It appeared to recognize that Mr. Chill could yet sue on the Commercial Lease.

The trial court appears to have concluded that the award the arbitrators made foreclosed the claims that Mr. Chill desired to make.

That conclusion amounted to error because it was based on untenable grounds. As discussed above, the arbitrators had no power to cancel the other agreements.

This issue is no small matter. It is well recognized that one clear reason to delay judgment before all claims are resolved is the need to offset judgments favorable to both parties before enforcement activity takes place. Furthermore, resolving all matters before final judgment avoids multiple appeals. *Loeffelhoelz v. Citizens for Leadership with Ethics and Accountability Now*, 119 Wn.App. 665, 694, 82 P.3d 1199 (2004); *Fluor Enterprises, Inc., v. Walter Construction, Ltd.*, 141 Wn.App. 761, 767, 172 P.3d 378 (2004).

It bears noting at this point that Matthew Smith Company's success at the arbitration does not mean that it will prevail on other claims. A purchaser of stock can obtain relief under the Washington State Securities Act by showing a failure to disclose material information. RCW 21.20.010(2). And, as discussed below, there is no requirement to prove damage proximately caused by any misrepresentation or failure to disclose. The other agreements are not governed by RCW 21.20 because they don't involve the sale of a security. RCW 21.20.005(12)(a); RCW 21.20.010. Any claim that Matthew Smith Company would make that these agreements were induced by fraud would require proof of an

affirmative misrepresentation of material fact and proof of consequent damage as well as justifiable reliance. *Farrell v. Score*, 67 Wn.2d 957, 411 P.2d 146 (1967). And in arms length business matters such as this, there is no duty to disclose. *Oates v. Taylor*, 31 Wn.2d 898, 199 P.2d 924 (1949); *Lincoln v. Keene*, 51 Wn.2d 171, 316 P.2d 899 (1957). Furthermore, Mr. Smith's justifiable reliance was at least subject to question especially when his own attorney suggested that his investigation of the company may not have been sufficient and when he indebted himself for more than the company's value. Finally, any relief could well be foreclosed to him under the doctrine of unclean hands because of his failure to disclose the \$1 million promissory note to Wachovia.

For these reasons, the trial court's grant of judgment under CR 54(b) was error. The judgment should be reversed.

ASSIGNMENT OF ERROR NO. 6: The trial court erred in granting a writ of attachment as to community real property.

I. Introduction.

The trial court authorized a writ of attachment for Mr. Chill's half interest in property acquired after his marriage to Mrs. Chill. It based this decision on its mistaken belief that the arbitration award represented

liability for a tort. For that reason, the grant of the writ of attachment was error.

II. The Property Was Community Property.

Mr. and Mrs. Chill were married in 2001. Four of the five attached properties were acquired thereafter. Matthew Smith Company has never contended otherwise. They were therefore presumptively community property. *Yesler v. Hochstettler*, 4 Wash. 349, 353-4, 30 P. 398 ((1892); *Jones v. Duke*, 151 Wash. 108, 275 P. 72 (1929); *Rustad v. Rustad*, 61 Wn.2d 176, 377 P.2d 414 (1963).

This presumption can be overcome by showing the source of the funds used to acquire the property. *In re Estate of Stockman*, 59 Wn.App. 711, 800 P.2d 1141 (1990). Matthew Smith Company never submitted any evidence to overcome this presumption.

The purpose of a writ of attachment is to secure property for the satisfaction of any judgment that a party may later recover. RCW 6.25.020; *Thompson v. DeHart*, 84 Wn.2d 931, 530 P.2d 272 (1975). The question then becomes whether Matthew Smith Company could reach this property in satisfaction of its claim against Mr. Chill.

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III. Matthew Smith Company Cannot Reach Community Property to Satisfy a Separate Obligation.

Matthew Smith Company made claim based on Mr. Chill's sale of stock in Charles Prescott Restoration Co. He had acquired this stock long before his marriage to Mrs. Chill. It was therefore his separate property. RCW 26.16.010.

Community property cannot be reached to satisfy debts related to stock that is separate property as the Supreme Court of Washington has held. *First National Bank of Juneau v. Estus*, 185 Wash. 174, 52 P.2d 1243 (1936), dealt with a judgment on a promissory note made by a shareholder in connection with a corporation. The stock was his separate property. *Achilles v. Hoopes*, 40 Wn.2d 664, 245 P.2d 1005 (1952), dealt with a judgment the defendant made to subscribe for corporate stock. That stock was separate property. In each case, the Court held that community property could not be reached to satisfy the obligation.

Our case is no different. The claim of Matthew Smith Company arises out of Mr. Chill's separate property, his stock in Charles Prescott Restoration Co. For that reason, Matthew Smith Company cannot levy on community property to satisfy its claim.

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IV. The Claim of Matthew Smith Company Is Not in Tort.

When a judgment creditor obtains a judgment based on a separate tort, he or she must first look to the judgment debtor's separate property. If that is not sufficient, the creditor can first levy on the tortfeasor's half of community personal property. If that does not satisfy the judgment, the creditor can reach the judgment debtor's half of community real property. *deElche v. Jacobson*, 95 Wn.2d 237, 622 P.2d 835 (1980); *Keene v. Edie*, 131 Wn.2d 822, 935 P.2d 588 (1997); *Haley v. Highland*, 142 Wn.2d 135, 12 P.3d 119 (2000). That rule underlay the trial court's grant of a writ of attachment as to Mr. Chill's one-half interest in the four properties. The claim of Matthew Smith Company, however, is not in tort.

Matthew Smith Company obtained relief based on RCW 21.20.430(1). This section parallels and is derived from Section 410 of the Uniform Securities Act of 1956. It allows an aggrieved party to sue "either at law or in equity to recover the consideration paid for the security." This relief is commonly referred to as "rescission" of the transaction although that word is found nowhere in RCW 21.20.430(1). *Clausing v. DeHart*, 83 Wn.2d 70, 515 P.2d 982 (1974); *Go2net, Inc. v. Freyellow.Com Inc.*, 158 Wn.2d 247, 143 P.3d 590 (2006); *Aspelund v. Olerich*, 56 Wn.App. 477, 784 P.2d 179 (1990).

It is generally recognized that the relief afforded by the Uniform Securities Act relief is not the same as tort damages. First of all, tort claims require proof of causation. *Christensen v. Swedish Hospital*, 59 Wn.2d 545, 548-9 (1962); *Safeco Insurance Company of America v. Butler*, 118 Wn.2d 383, 389 (1992). In contrast, rescission allowed by the Uniform Securities Act requires no proof of causation. IX Loss & Seligman, *Securities Regulation*, 4199 (1992); *Lolkus v. Vander Wilt*, 258 Iowa 1074, 141 N.W.2d 600 (1966). This can be clearly seen by a review of RCW 21.20.430(1). The statute contains no causation requirement. It should be contrasted to RCW 19.86.090, the remedial section of the Consumer Protection Act. The latter statute allows damages only to those who are injured by an unfair or deceptive act in the course of a trade or business. On that basis, recognized commentators have noted that the rescissionary damages a purchaser receives under the Uniform Securities Act is not a tort recovery. 12A *Blue Sky Law* 19:188, 19:198.

The arbitrators granted Matthew Smith Company relief under RCW 21.20.430(1). That is not a tort recovery. For that reason, it cannot reach Mr. Chill's one-half interest in community property to satisfy its judgment.

V. The Grant and Levy of the Writ of Attachment Violated the Due Process Clause of the Fourteenth Amendment to the United States Constitution.

A person whose property is to be attached is entitled to notice and an opportunity to be heard before the writ is levied. This right is guaranteed by the Due process Clause of the Fourteenth Amendment to the United States Constitution. It applies even when the interference with the property is temporary or partial. *Connecticut v. Doeher*, 501 U.S. 1, 12, 111 S.Ct. 2105, 115 L.Ed.2d 1 (1991). The rule also allows relief to those who had no interest in the property at the time of levy. *Allyn v. Asher*, 132 Wn.App. 371, 131 P.3d 339 (2006). The process by which the writ of attachment was obtained and levied violated this rule. Therefore, the trial court erred by granting the writ of attachment.

The only two parties in this case are Matthew Smith Company and Donald Chill. Notwithstanding that it sought to attach community property, Matthew Smith Company did not join Abigail Chill as a party or provide notice to her of its motion for a writ of attachment. Mr. Chill and Jeffrey Rauth obtained the fifth property on a real estate contract. There is no showing that Mr. Rauth ever conveyed away his interest in the property. (CP 113-14) He was also entitled to notice and an opportunity to be heard. In the absence of notice and an opportunity to be heard

granted to Ms. Chill and Mr. Rauth, the trial court should not have granted the writ of attachment.

Matthew Smith Company may argue that the trial court's order allows only Mr. Chill's half of the parcels that are community property to be attached. The language of the writ, however, does not contain that limitation. In other words, despite the court's order, Ms. Chill's interest in the parcels has been attached.

VI. Conclusion.

Four of the attached properties are community property. Matthew Smith Company recovered on a separate obligation not in tort. Therefore, Matthew Smith Company cannot reach community property to satisfy its claim. Furthermore, the writs were obtained in violation of the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States. That vitiates the writ of attachment as to all five properties. The trial court erred by granting a writ of attachment as to Mr. Chill's one-half interest in the four properties.

STATEMENT PURSUANT TO RAP 18.1(A)

Mr. Chill seeks attorney's fees on appeal. This is based on three contractual provisions. These are Section 19.16 of the Stock Purchase

Agreement; Section VIII of the \$1 million promissory note; and Section 16.2 of the Commercial Lease. (CP 19, 49, 409)

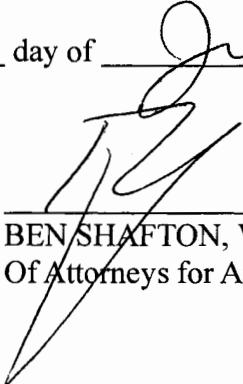
This appeal deals with the proper interpretation of the arbitration clause in the Stock Purchase Agreement. Section 19.16 of the Stock Purchase Agreement provides for attorney's fees to the prevailing party on appeal in that eventuality. Mr. Chill is also seeking to enforce his rights under the \$1 million promissory note and the Commercial Lease. Section VIII of the note allows for an award of attorney's fees to the prevailing party in an action to collect monies due under the note as qualified by RCW 4.84.330. Section 16.2 of the Commercial Lease provides for attorney's fees to the prevailing party in any controversy arising out of the lease on appeal.

CONCLUSION

The trial court erred by denying the motion to modify or vacate the arbitration award; by granting the writ of attachment; by confirming the arbitration award as entered; and in granting judgment to Matthew Smith Company pursuant to CR 54(b). The Court should reverse the judgment on that basis. It should also direct the trial court to vacate the writ of attachment and modify the arbitration award such that the provisions

cancelling the \$1 million promissory note and the other contracts between
the parties are vacated.

DATED this 4 day of June, 2008.



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NO. 37541-9-II

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

MATTHEW SMITH COMPANY, INC.,

Plaintiffs/Respondents

vs.

DONALD C. CHILL,

Defendant/Appellant

APPEAL FROM THE SUPERIOR COURT

THE HONORABLE ROGER A. BENNETT

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