

COURT OF APPEALS
DIVISION II

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STATE OF WASHINGTON

Case No. 40585-7-II

BY

DEPUTY

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

SOUNDBUILT NORTHWEST, LLC,
a Washington limited liability company,
Respondent,

v.

THOMAS PRICE and PATRICIA PRICE, husband and wife,
individually and their marital community composed thereof; and
HYUN UM and JIN S. UM, husband and wife, individually
and their marital community composed thereof,
d/b/a P & U CAPITAL PARTNERS LLC,
non-existent Washington limited liability company,
Appellants.

**RESPONDENT SOUNDBUILT NORTHWEST LLC'S
BRIEF IN RESPONSE TO APPELLANTS' OPENING BRIEF**

Counsel for Respondent
Soundbuilt Northwest LLC

Paul E. Brain, WSBA #13438
BRAIN LAW FIRM PLLC
1119 Pacific Avenue, Suite 1200
Tacoma, WA 98402
Tel: 253-327-1019
Email: pbrain@paulbrainlaw.com

ORIGINAL

TABLE OF CONTENTS

I. INTRODUCTION	1
II. RESPONDENT’S STATEMENT OF THE CASE	5
A. Membership in 176 th Street LLC.	5
B. The Negotiations for the MUSA/PSA.	7
C. The Borrowings.....	11
D. The Prior Litigation.....	15
III. ARGUMENT	16
A. Piercing the Veil Under RCW 25.15.060.	16
B. Liability on the Basis of RCW 23B.02.040.	18
C. The Scrivener’s Error/Reformation Issue.	22
D. The Res Judicata /Collateral Estoppel Issue.	27
1. Different Subject Matter.....	28
2. Different Causes of Action.....	29
3. Different Persons and Parties.	30
4. Quality of the Persons for or Against Whom the Claim is Made.	31
E. Miscellaneous Issues:.....	32
1. The Consolidation Which Formed Respondent.	32
2. Respondent’s Additional Damages of \$1.3 Million.	33
IV. CONCLUSION	33

TABLE OF AUTHORITIES

Cases

<u><i>Abramson v. University of Hawaii</i></u> , 594 F.2d 202 (9th Cir. 1979).....	29
<u><i>Akers v. Sinclair</i></u> , 37 Wn.2d at 703, 22 P.2d 225 (1951)	23
<u><i>Brown v. Scott Paper Worldwide Company</i></u> , 98 Wn. App. 349, 989 P.2d 1187 (1999).....	31
<u><i>Cavanaugh v. Brewington</i></u> , 3 Wn. App. 757, 477 P.2d 644 (1970)	23
<u><i>Chadwick Farms Owners Ass’n v. FHC LLC</i></u> , 166 Wn.2d 178, 207 P.2d 1251 (2009).....	2, 17
<u><i>City of Arlington v. Cent. Puget Sound Growth Mgmt. Hearings Bd.</i></u> , 164 Wn.2d 768, 193 P.3d 1077 (2008)	31
<u><i>Costantini v. Trans World Airlines</i></u> , 681 F.2d 1199 (9th Cir.), <i>cert. denied</i> , 103 S.Ct. 570 (1982).....	29
<u><i>Curtiss v. Crooks</i></u> , 190 Wn. 43, 66 P.2d 1140 (1937).....	29
<u><i>Drake v. Ross</i></u> , 3 Wn. App. 884, 478 P.2d 251 (1970).....	32
<u><i>Ensley v. Pitcher</i></u> , 152 Wn.2d 891, 222 P.3d 99 (2009).....	27
<u><i>Equipto Div. Aurora Equipment Co. v. Yarmouth</i></u> , 134 Wn.2d 356, 950 P.2d 451 (1998).....	18, 21
<u><i>Estate of Stalkup v. Vancouver Clinic, Inc. P.S.</i></u> , 145 Wn. App. 572, 187 P.3d 291 (2008).....	32
<u><i>Geoghegan v. Dever</i></u> , 30 Wn.2d 877, 194 P.2d 397 (1948).....	22
<u><i>Harris v. Jacobs</i></u> , 621 F.2d 341 (9th Cir. 1980).....	29
<u><i>Hayes v. City of Seattle</i></u> , 131 Wn.2d 706, 934 P.2d 1179 (1997)	28
<u><i>Hisle v. Todd Pac. Shipyards</i></u> , 151 Wn.2d 853, 93 P.3d 108 (2004).....	28
<u><i>Kaufmann v. Woodard</i></u> , 24 Wn.2d 264, 270, 163 P.2d 606 (1945).....	23
<u><i>Keierleber v. Botting</i></u> , 77 Wn.2d 711, 466 P.2d 141 (1970)	23
<u><i>Meder v. CCME Corp.</i></u> , 7 Wn. App. 801, 502 P.2d 1252 (1972)	29
<u><i>Mellor v. Chamberlin</i></u> , 100 Wn.2d 643, 673 P.2d 610 (1983)	28
<u><i>National Bank of Washington v. Equity Investors</i></u> , 81 Wn.2d 886, 506 P.2d 20 (1973):.....	10, 26
<u><i>Nationwide Mutual v. Watson</i></u> , 120 Wn.2d 178, 840 P.2d 851 (1992).....	23
<u><i>Owens v. Kuro</i></u> , 56 Wn.2d 564, 354 P.2d 696 (1960).....	30
<u><i>Payless Car Rental Sys., Inc. v. Draayer</i></u> , 43 Wn. App. 240, 716 P.2d 929 (1986).....	32
<u><i>Perry v. Continental Ins. Co.</i></u> , 178 Wash. 24, 33 P.2d 661 (1934)	10, 26
<u><i>Rains v. State</i></u> , 100 Wn.2d 663, 674 P.2d 165 (1983).....	27

<i>Reynolds v. Farmers Ins. Co.</i> , 90 Wn. App. 880, 960 P.2d 432 (1998).....	23
<i>Riblet v. Ideal Cement Co.</i> , 54 Wn.2d 779, 345 P.2d 173 (1959)	30
<i>Rufener v. Scott</i> , 46 Wn.2d 240, 280 P.2d 253 (1955)	30
<i>Seattle First Nat'l Bank v. Kawachi</i> , 91 Wn.2d 223, 588 P.2d 725 (1978).....	27
<i>Shoemaker v. City of Bremerton</i> , 109 Wn.2d 504, 745 P.2d 858 (1987).....	32
<i>Simonson v. Fendell</i> , 101 Wn.2d 88, 675 P.2d 1218 (1984)	23
<i>Skagit State Bank v. Rasmussen</i> , 109 Wn.2d 377, 745 P.2d 37 (1987).....	10, 22, 25
<i>Sodak Distrib. Co. v. Wayne</i> , 77 S.D. 496, 93 N.W.2d 791 (S.D. 1958)	30
<i>State v. Stevenson</i> , 128 Wn. App. 179, 114 P.3d 699 (Div. 2 2005)	10
Statutes	
RCW 23B.02.040.....	17, 18, 20, 22
RCW 25.15.060	16
RCW 25.15.070	21
RCW 25.15.105	19

I. INTRODUCTION

The basic issue in this case was, from the inception, whether Thomas Price (“Price”) and Hyun Um (“Um”), together with their respective marital communities (collectively “Appellants”), could be held personally responsible for the concurrent breach of two interrelated agreements:

1. An agreement for the sale of certain membership units in a limited liability company, 176th Street LLC (the Membership Unit Sale Agreement (“MUSA”) (*Trial Ex. 2 at SBH 1453-1457*)), which held a real property asset under development as a 180-lot residential subdivision; and
2. A purchase and sale agreement (“PSA” (*Trial Ex. 2 at SBH 1458-1472*)) for the lots in that subdivision on completion of development which PSA was, in part, consideration for the sale of the membership units.

Predecessors in interest to the Respondent (collectively “Respondent”) were the seller of the membership units and the purchaser of the lots. The putative purchaser of the membership units was a limited liability company specifically identified in the MUSA, a subsequent Addendum to the MUSA, a Bill of Sale for the membership units, and an Annual Report filed with Washington’s Secretary of state as “P & U Capital Partners LLC” (“PUCP”). Appellants acknowledge that PUCP never existed.

Ultimately, Respondent asserted two bases for holding Price and Um personally responsible. First, Respondent asserted that the various limited liability companies which Appellants claimed insulated Appellants from liability were simply “alter egos” for Price and Um. (*CP 6 at ¶ 3.8*).

As Appellants themselves note in their Opening Brief, to pierce the veil of a limited liability company so that liability can attach to a member, a plaintiff must prove that the limited liability company form was used to avoid a duty and that the limited liability company form must be disregarded to prevent loss to an innocent party. Chadwick Farms Owners Ass'n v. FHC LLC, 166 Wn.2d 178, 207 P.2d 1251 (2009).

The evidence in this regard is that, at the time the PSA was repudiated, the value of the lots was as high as \$18 million. (*Transcript of Proceedings ("TP") 69:5-73:19*). The development expense records produced by Price and Um show that \$10.7 million was expended on development costs (*Trial Ex. 23 and TP 113-115*) and the purchase price for the property in the PSA was \$11.8 million (*Trial Ex. 2 SBH 1458-1472 and TP 116, Finding 8*); in transactions which make no economic sense except as a means for diverting value from the property, \$13.9 million in principal amount was borrowed against the property. \$5.5 million of the borrowings was borrowed in second position from a "hard money lender" long after mutual acceptance of the PSA (*Trial Exs. 8-10, and TP 120-122*) and personally guaranteed by Appellants. Shortly after borrowing the last \$2.3 million and, shortly after repudiating the PSA, the property was transferred to the lender through a Deed in Lieu of Foreclosure, which extinguished guarantors' personal liability. (*Trial Ex. 11*).

About \$3.2 million went missing in the process, with no explanation as to where that money went, of which \$2.1 million were profits belonging to Respondent, based on the purchase price in the PSA. (*TP 122*). Irrespective of what happened to the missing money, Um's and Price's

individual guaranty liability to the lender was extinguished (*TP 297-298*) and their personal financial position substantially bettered at the expense of Respondent's predecessors in interest.

Ultimately, Respondent purchased the property from that lender for the amount of the debt – \$14.5 million including accrued interest and late fees. Including additional costs to complete the development, Respondent, a wholly-innocent party, suffered a \$4 million loss, exclusive of interest.

Second, the MUSA and all related documents and drafts identified PUCP as the purchaser of the membership units. However, Appellants admit that no such entity was ever formed. Appellants do not dispute that, under applicable law, the organizers of a limited liability company which was never properly formed are responsible for the debts of the limited liability company. In this case, because a breach of the PSA was concurrently a breach of the MUSA, Price and Um would be responsible for the debt created by that breach.

As a defense, Appellants have asserted that the identification of the purchaser of the units under the MUSA as PUCP rather than P & U Capital Partners I LLC ("P&U I") was either a scrivener's error on the part of Respondent's counsel or a mutual mistake. On these defenses, the burden of proof of Appellants is under a clear, cogent and convincing standard.

Appellants contend that the intent of the parties was that the membership units were to be sold to the member of 176th Street LLC controlled by Price and Um. The testimony was that Respondent did not care who the purchaser was and played no role in the identification of the purchaser. In fact, PUCP was first identified as a party to the proposed

transaction by Appellants. (*Trial Ex. 39*). The process of generating the MUSA and PSA between Respondent's counsel and Appellants' counsel was collaborative. Although Appellants' counsel had multiple opportunities to correct the identity of the purchaser in these exchanges, Appellants' counsel did not do so.

According to Appellants, the members of 176th Street LLC were Respondent and P&U I. While P&U I is identified in the Operating Agreement (*Trial Ex. 1*) as a member of 176th Street LLC, P&U I is never identified as a member of 176th Street LLC in any of the Annual Reports filed with the state or in any of the draft or final transaction documents pertaining to the MUSA or PSA (*Trial Ex. 34*). At various times, Um is identified as a member of 176th Street LLC. PUCP is identified as a member. Sunridge Homes, one of Respondent's predecessors and the lot purchaser under the PSA, is identified as a member. Michael Mastro, the lender, is identified as a member. **But never P&U I.** Thus, even if it was the intent to transfer the membership units to "the other member" of 176th Street LLC, there is no clear, cogent and convincing evidence either that P&U I was actually a member of 176th Street LLC or that P&U I was intended to be the transferee.¹

¹ Appellants have also appealed the entry of Charging Orders with respect to interests held by them in two holding company limited liability companies. In a prior Motion to Vacate the Charging Orders directed to this Court, Commissioner Schmidt held on August 17, 2010, that "appellants have already transferred their management rights." With respect to the second, Commissioner Schmidt held that the issues were moot. Since that date, both Appellants have filed bankruptcy, further rendering the issues with respect to the Charging Order wholly academic since Respondent has no available mechanism for enforcing the Charging Order. Rather than cloud the record, Respondent would refer the Court to Respondent's Response on the Motion for Relief from Charging Order dated August 13, 2010.

II. RESPONDENT'S STATEMENT OF THE CASE

A. Membership in 176th Street LLC.

Prior to the trial in this matter, Respondent operated as two different corporate entities: Sound Built Homes, Inc. ("SBH") and Sunridge Homes, Inc. ("Sunridge").² In 2000, Sunridge entered into a limited liability company operating agreement for 176th Street LLC. (*Trial Ex. 1*). The Operating Agreement does identify P&U I as the other member of the limited liability company as of 2000.

Appellants contend: "There were no other members to this LLC [176th Street LLC]." (*6/18/10 Opening Brief at p. 8*). Price testified that Sunridge and P&U I were the only members of 176th Street LLC. (*Trial Ex. 43 at ¶¶ 3-4*). **Um testified that he was never individually a member of 176th Street LLC.** (*TP 310*). Both Price (*TP 363*) and Um (*TP 375*) testified that PUCP never existed as a legal entity.

Trial Ex. 34 consists of the Certificate of Formation and Annual Reports filed with Washington's Secretary of State for 176th Street LLC. The 2000 Initial Annual Report identifies Um as a member – not P&U I. But, **Um testified that he was never individually a member of 176th Street LLC.** The Certificate of Formation (*Trial Ex. 34 at p. 2*) states that 176th Street LLC is a member-managed limited liability company. As noted on the annual reports, where a limited liability company is member managed, the annual report is supposed to identify all of the members.

² Both SBH and Sunridge were consolidated into Respondent after the events at issue in this litigation. Respondent was substituted as the named party pursuant to an Order dated February 13, 2009. (*CP 22*).

For example, the 2001 Annual Report (*Trial Ex. 34 at p. 4*) identifies 176th Street LLC as a member-managed limited liability company and states: “List the name and address of managers, if applicable. Otherwise, list the name and address of managers.” The 2001 Annual Report, signed by Price, identifies Sunridge and PUCP as members – but not P&U I.³

The 2002 and 2003 Annual Reports identify Um as a member. (*Trial Ex. 34*). **Um testified that he was never individually a member of 176th Street LLC.** (*TP 310*). 2003 is the year in which the MUSA/PSA transaction took place. According to Um all of these Annual Reports through 2003 were filled out by Price and bear his handwriting even where signed by Um. (*TP 311-312*).

As stated in the MUSA (*Trial Ex. 2, at SBH 1453, ¶ 1.2*), the sole asset of 176th Street LLC was the right to purchase real property capable of development as a residential subdivision under a purchase and sale agreement attached to the MUSA (*Trial Ex. 2 at SBH 1473-1484*). Paragraph 7 of the MUSA obligates Sunridge to assign Exhibit 4 to 176th Street LLC. The assignment is Trial Ex. 4 and was executed by Um in his capacity as an individual managing member of 176th Street LLC. But, **Um testified that he was never individually a member of 176th Street LLC.** (*TP 310*). P&U I is not referenced in the signature block or elsewhere in the document. Trial Ex. 8 is a Deed of Trust executed by Um in his

³ Um testified that he signed the 2001 Annual Report which otherwise bore Price’s handwriting. (*TP 312*). However, if the signature is compared to the documents actually signed by Um, it is obviously not Um’s signature. However, compare the signature on this Annual Report to the signature on Trial Ex. 43, the Price Declaration.

capacity as an individual member of 176th Street LLC. *Um testified that he was never individually a member of 176th Street LLC.* (TP 310).

Trial Ex. 9 is also a Deed of Trust executed by Um in his capacity as an individual member of 176th Street LLC. *Um testified that he was never individually a member of 176th Street LLC.* (TP at 310).

B. The Negotiations for the MUSA/PSA.

Appellants make the statement that: “The original proposal was to have P & U Capital Partners I LLC sell its interest [in 176th Street LLC] to Sunridge Homes, Inc.” (6/18/10 *Opening Brief at 10*). This is **categorically** not true. Trial Ex. 39 is the first communication between the parties regarding a possible transfer of interests in 176th Street LLC. The fax transmittal sheet has been initialed by Um. The attached proposed transfer agreement identifies PUCP as the party to the transfer agreement, consistent with the identification of PUCP as a member of 176th Street LLC in the 2001 Annual Report, signed by Price.

Appellants assign error to the Trial Court’s findings that Respondent’s counsel was not the scrivener of the PUSA/PSA. (6/18/10 *Opening Brief at p. 4, ¶ 4*). Counsel to SBH and Sunridge, David Kerruish, testified that the idea of having an entity related to Price and Um be the purchaser of the membership units rather than Sunridge emanated from Appellants. (TP 227). Mr. Kerruish identified Trial Ex. 39 as the documentation on which he relied in identifying the parties to the proposed transaction in a draft MUSA. (TP 215-216). According to Mr. Kerruish, locking the purchaser of the membership units into a fixed price for the lots was a critical element of the transaction because lot prices were “sky

rocketing.” (TP 229-231). In this regard, ¶ 9 of the MUSA specifically enumerates that part of the consideration for the sale of the membership units was the PSA. *Trial Ex. 2 at SBH 1455*.

Mr. Kerruish described the process of generating the MUSA/PSA and related documents as “interactive” and that the documents reflect contributions from Appellants’ counsel, Matthew Sweeney. (TP 231-232). This testimony is clearly borne out by the exchanges of correspondence relating to the transaction from Mr. Kerruish’s files. (*Trial Ex. 41*). According to Mr. Kerruish, the identity of the purchaser was provided by Appellants, Mr. Sweeney never objected to the identification of PUCP as the purchaser, and Mr. Kerruish never made any inquiries regarding the identity of the purchaser of the units because that identity was not material. (TP 236-237). As Mr. Sweeney did not testify, Mr. Kerruish’s testimony in this regard is undisputed.

Appellants go on to state: “Kerruish admitted that if the Operating Agreement were correct in the proper identification of the parties (which it is undisputed that it was), then he made a mistake in drafting the Agreement.” (6/18/10 *Opening Brief at p. 17*). This misrepresents the testimony. Mr. Kerruish testified:

- Q. (By Appellants’ Counsel) Mr. Kerruish, would you, please, look at the last page of ... the operating agreement of 176th Street LLC?
- A. Yes, I -- I have it in front of me.
- Q. Do you see at the -- on the final page of that, marked P & U 0026 where the 50 percent member is listed as P & U Capital Partners, Roman Numeral I, LLC?
- A. I do see that.

- Q. Now, if this document was correct as to the ownership, and the ownership remained unchanged, you were mistaken, were you not, as to who the owner of that 50 percent interest was?
- A. No. Not necessarily. I -- I don't know what changes might have taken place.
- Q. My question, ask you if there -- if it remained unchanged, then you would have been mistaken; isn't that correct?
- A. I -- yeah. I don't know that -- I don't know what the operating agreement is correct versus what was filed with the Secretary of State or versus anything else.

(*TP 244:16-245:10*). On redirect, Mr. Kerruish was clear that, to the extent a mistake had been made as to the identity of the purchaser, the mistake was entirely on "the other side of the table." (*TP 286:10-287:25*).

The assertion that the identity of the other member of the 176th Street LLC was undisputed is simply incorrect and contrary to multiple documents prepared and executed by Appellants and filed as a matter of public record on their behalf. Not one of the numerous documents executed by Um relating to this transaction or the subsequent encumbrances in favor of Mr. Mastro identifies P&U I as a member of 176th Street LLC – five annual reports and three Mastro Deeds of Trust.

While Price testified that the only other member of 176th Street LLC was P&U I and that the sole member of P&U I was Prium Companies LLC (*Trial Ex. 43*), Um executed, in the capacity of the managing member of "P & U Capital Partners LLC" the MUSA (*Trial Ex. 2*), a Bill of Sale for the membership units (*Trial Ex. 3*)⁴ and an amendment to the PSA (*Trial*

⁴ Appellants contend that the Court "erred in finding that Mr. Um was the managing member of an entity called P & U Capital Partners LLC and erred in finding that he

Ex. 7). Um testified that he was never individually a member of 176th Street LLC. (TP 310). To contend that the identification of the purchaser was a scrivener's error by Respondent's counsel under these circumstances is simply ludicrous.

In fact, Appellants themselves disputed the ownership of 176th Street LLC. According to Um, all of these documents are mistaken. (TP 313-316). Also, according to Um, he did not read the documents to ensure they were correct before signing them. (TP 319:2-14). Unfortunately for Um and Price, as the Court noted in Skagit State Bank v. Rasmussen, 109 Wn.2d 377, 745 P.2d 37 (1987):

The relevant principles are summarized in National Bank of Washington v. Equity Investors, 81 Wn.2d 886, 912-13, 506 P.2d 20 (1973):

It is a general rule that a party to a contract which he has voluntarily signed will not be heard to declare that he did not read it, or was ignorant of its contents. Perry v. Continental Ins. Co., 178 Wash. 24, 33 P.2d 661 (1934). One cannot, in the absence of fraud, deceit or coercion be heard to repudiate his own signature voluntarily and knowingly fixed to an instrument whose contents he was in law bound to understand.

Moreover, the testimony by Um is simply not credible. It is equally true that it was within Judge Stolz's discretion to judge the credibility of the testimony offered by Price and Um. "The fact finder measures witness credibility, and we do not review credibility determinations on appeal." State v. Stevenson, 128 Wn. App. 179, 114 P.3d 699 (Div. 2 2005) (Court's footnote 11).

executed a bill of sale on behalf of any such entity. (6/18/10 Opening Brief at p. 4). One wonders if counsel has bothered to read these exhibits.

Finally, the underlying assertion, that Respondent's side of the transaction cared or had any intent with regard to the identity of the purchaser is without support in the record. Both Price and Um participated in a meeting involving the negotiations for the MUSA/PSA. (*TP 99-100*).⁵ Sunridge and SBH were represented in this single meeting between the principals by Gary Racca and Kurt Wilson. As Mr. Wilson testifies, the identification of the purchaser for the membership units was "solely up to" Price and Um and Respondent played no role in identifying PUCP as the purchaser. Mr. Wilson testified that the issue of who the purchaser would be was left to counsel to work out. (*See TP 99-100*). As Mr. Kerruish testified, he did not consider the identity of the purchaser to be material to his representation of Respondent's side of the transaction. (*TP 236-237*).

C. The Borrowings.

176th Street LLC borrowed \$8.823 million from Washington Federal Savings, of which \$4.9 million were deposited into a construction account. The remainder was the purchase price of the property. (*Trial Ex. 35*). After August 25, 2003, in addition to an \$8.823 million acquisition/construction loan, 176th Street LLC borrowed from Mr. Mastro an additional \$5.05 million. The property was burdened with three additional Deeds of Trust:

⁵ Appellants assign error to Finding No. 6 asserting "there was no evidence presented at trial that Mr. Price was involved in a discussion for a purchase and sale of membership units in 176th Street LLC." (*6/18/10 Opening Brief at p. 3*). Mr. Wilson's testimony that Price did participate is actually uncontroverted in the record.

Grantor	Grantee	Amount Secured	Recording No.
176th Street LLC	Mastro	\$1,100,000	200501260274
176th Street LLC	Mastro	\$1,650,000	200501260275
176th Street LLC	Mastro	\$2,300,000	200506210495

(*Trial Exs. 8-10 respectively*). The Deeds of Trust were all executed by Um as a member of 176th Street LLC. These debt obligations were personally guaranteed by Um. In principal amount, the loans secured against the property total \$13.9 million.

The development expense records produced by Price and Um show that \$10.7 million was expended on development costs. (*Trial Ex. 23 and TP 113-115*). Thus, the borrowings against the property, based on Appellants own records, exceeded the purchase price in the PSA by about \$2.1 million.

As specified in ¶ 5 of the PSA (*Trial Ex. 2 at SBH 1459*), title to the lots was to be delivered “by statutory warranty deed free of encumbrances.” The purchase price for the lots was \$11.8 million. (*TP 116*). The principal amount of the debt against the property was \$13.9 million. The difference between the purchase price and the principal amount of the debt, exclusive of any accrued interest or other charges owed to the secured lenders, was over \$2 million. In order to comply with the condition relating to title, over \$2 million would had to have been delivered to escrow by the seller of the lots to clear the Deeds of Trust securing the Washington Federal and Mastro debt and to comply with ¶ 5 of the PSA.

Appellants contend: “There was no evidence presented at trial that defendants Price personally guaranteed any such debt.” (6/18/10 *Opening Brief* at p. 6, ¶ 8). Price’s testimony was, in fact, as follows:

Q. [By Mr. Brain] Okay. With respect to the Mastro loans, there were three of them; right?

A. Yes.

Q. Were those obligations guaranteed by anybody?

A. I believe they were all guaranteed by Mr. Um and, I might have guaranteed them too.

(TP 297:1-11).

Mr. Racca, the principal shareholder in Respondent and its predecessors, testified that since 2003, Mr. Wilson has been responsible for negotiating financing for the acquisition of development properties. (TP 40). Mr. Wilson has testified that in every case, a personal guaranty by Mr. Racca was required by the lender. (TP 40:11-21).

It is undisputed that the seller of the Frederickson Estates plat repudiated the PSA because, neither Um nor Price wanted to “have to write a check to close the deal.” (TP 366:20-367:11). Um and Price would have had to write a check to Mastro for the difference between the purchase price to SBH and the debt owed to Mastro because each had personally guaranteed that debt.

It is undisputed that on October 15, 2005, Um, on behalf of 176th Street LLC, signed a Deed in Lieu of Foreclosure quitclaiming 176th Street LLC’s interest in the Frederickson Estate plat to the lender, Mastro. (Trial Ex. 11). The effect of the Deed in Lieu was to extinguish

any liability of Price and Um on the personal guaranty of the debt to Mastro. (*TP 297:22-298:11*).

The question is: why did Price and Um over-encumber the property beyond the purchase price in the PSA? The last Deed of Trust was recorded on June 21, 2005 – just a couple of months *before* the PSA was repudiated. Price explained that the hope was that Respondent would agree to renegotiate the price. (*TP 298-299*). However, Respondent was not approached regarding a re-negotiation of the price until after June 2005. (*See TP 123:17-23 and Trial Ex. 24*). That Price and Um would increase their personal liability depending on a renegotiation of the purchase price – which negotiation had not even been initiated – makes no economic sense whatsoever. In fact, neither Price nor Um ever offered an explanation for the borrowing in excess of the PSA purchase price.

What does make sense is that the borrowing was intended to pull value out of the property that otherwise would have gone to Respondent under the PSA. As Mr. Kerruish explained, during this time, lot prices were “skyrocketing.” Mr. Wilson offered the same testimony. (*TP 47:2-8; 59:6-60:11*). Mr. Wilson also testified that, at the time the PSA was repudiated, the lots were worth as much as \$18 million. (*TP 69:5-74:3*). If the terms of the PSA had been met, Appellants would not have had any ability to participate in that increase in value over the PSA purchase price. Respondent was left with the choice of either closing with Mastro and capturing some of the value, or protracted litigation.

Finally, it is undisputed that SBH, in order to acquire title to the Frederickson Estates lots, paid the lender (Mastro) \$14.5 million (*Trial*

Exs. 15-16) – \$2.65 million more than the price in the PSA. Respondent was experiencing a great deal of competition for lots. (*TP 59:6-60:11*). It simply made more sense for Respondent to close with Mastro at \$14.5 million, than continue litigation as the purchase price was still under market. But, at least a portion of the benefit of the original bargain – \$2.65 million in appreciation in lot value – was lost. In addition, SBH paid \$1.3 million in costs to complete the plat improvements of which the seller was contractually obligated to complete. (*TP 193*). In total, SBH incurred losses of almost \$4 million as a result of the repudiation of the PSA, which was in turn, a breach of the MUSA. The issue here is whether Appellants have any liability for the damages incurred by Respondent.

D. The Prior Litigation.

SBH was the purchaser of the lots under the PSA. On August 29, 2005, SBH brought an action in Pierce County Superior Court against 176th Street LLC, by way of a Complaint styled “Complaint for Declaratory Relief and Specific Performance” (the “2005 Lawsuit”). (*Trial Ex. 25*). As stated in that Complaint, SBH sought equitable relief against 176th Street LLC in two forms:

1. For declaratory relief that any lack of profitability in the sale of the Fredrickson Estates Plat would not excuse 176th Street LLC performance of its obligations under the PSA and that 176th Street LLC would be obligated to timely perform on its obligations under the PSA; and
2. For specific performance under the PSA.

Sunridge, the party to the MUSA, was not a party to the 2005 Lawsuit. The Complaint: (a) was not based upon any allegations of breach of the MUSA; (b) did not identify Price and Um as Defendants; (c) made no

claim regarding avoidance of the limited liability company form to establish personal liability; (e) did not seek damages from any party; and (f) did not allege any wrongdoing on the part of Appellants here that resulted in a loss to SBH.

III. ARGUMENT

A. Piercing the Veil Under RCW 25.15.060.

In general, Appellants' assignments of error are based on the argument that Price and Um cannot be held personally liable in this case. For example, Assignment of Error No. 7 challenges a Finding that Price and Um informed Mr. Racca that the subdivision of the property would not be finished based on the contention that neither was acting in their individual capacity. (*6/18/10 Opening Brief at p. 5*). In other words, the Findings which result in liability are all in error because Price and Um are insulated from liability because of an intervening limited liability company. Obviously, if the limited liability company form can be ignored on any basis, these assignments of error have no validity.

This Court found that personal liability was justified under RCW 25.15.060 (Conclusion 1) which provides:

Members of a limited liability company shall be personally liable for any act, debt, obligation, or liability of the limited liability company to the extent that shareholders of a Washington business corporation would be liable in analogous circumstances. In this regard, the court may consider the factors and policies set forth in established case law with regard to piercing the corporate veil,...

As previously noted, Appellants themselves admit in their Opening Brief, that the limited liability veil of a limited liability company can be pierced

so that liability can attach to a member where it is proven that the limited liability company form was used to avoid a duty and that the limited liability company form must be disregarded to prevent loss to an innocent party. Chadwick Farms Owners Ass'n v. FHC LLC, 166 Wn.2d 178, 207 P.2d 1251 (2009).

Appellants state that “there was no evidence that this hypothetical limited liability company was used to violate or evade a duty.” (6/18/10 *Opening Brief at p. 38*). There is substantial evidence to conclude that Price and Um deliberately over-encumbered the property in order to pocket several millions of dollars in value they had already committed to sell to Respondent and, then, deeded the property to the lender in order to escape personal liability for the loans which allowed them to pocket the several millions of dollars. There is no question that Price and Um were hiding behind the limited liability company form to avoid liability to Respondent.

This conduct could not be shielded from liability unless it was under the auspices of one of the limited liability companies involved here. To the extent that Price and Um were operating under the shield of a limited liability company, that shield could clearly be ignored. If the Court concludes that the MUSA should be reformed, liability would still attach to Price and Um because whatever limited liability companies are argued to be a shield could be ignored. Alternatively, if liability attaches to Price and Um because “P & Capital Partners” was never a valid limited liability company, then the issue of piercing the veil need not be addressed.

B. Liability on the Basis of RCW 23B.02.040.

Appellants assert that “there was no evidence to fulfill the requirement that Price and Um were knowingly acting on behalf of [an] entity that was not [formed],” and, therefore, are not liable under RCW 23B.02.040. (6/18/10 *Opening Brief at p. 39*). This statement distorts the requirements of the statute. RCW 23B.02.040 states:

All persons *purporting to act* as or on behalf of a corporation, *knowing there was no incorporation* under this title, are jointly and severally liable for liabilities created while so acting except for any liability to any person who also knew that there was no incorporation.

(*Emphasis added*).

The requirements for liability under RCW 23B.02.040 have actually been considered by a Court only once and there in the context of a post-dissolution transaction rather than a pre-formation transaction as here. *See Equipto Div. Aurora Equipment Co. v. Yarmouth*, 134 Wn.2d 356, 950 P.2d 451 (1998). Nevertheless, the application of the statute to a given situation appears to be based on the answer to two questions:

1. Were the Appellants purporting to act on behalf of a liability limiting entity? and
2. Did Appellants know that entity did not exist as a legal entity?

The phrase “purporting to act” has not received judicial interpretation. A thesaurus will tell you that the term is synonymous with either “represented as” or “intending to be.” “Holding themselves out as” would be an alternative interpretation. It is unclear whether question 1 is to be addressed from the perspective of the person seeking the shield or the

person seeking to pierce it. In either case, the evidence supports the conclusion that Price and Um were purporting to act on behalf of PUCP.

The original proposal regarding a sale of 176th Street LLC emanated from Um and identified PUCP as the potential party to a transaction. Both Price and Um participated in the only meeting between principals involving the negotiations for the MUSA/PSA. (*TP 99-100*). Thereafter, multiple drafts of various documents relating to the transaction were circulated between counsel, all of which identified PUCP as the other party to the transaction. Um executed the MUSA, an Addendum to the PSA and a Bill of Sale for the 176th Street LLC units on behalf of PUCP.

In 2001, Price filled out and executed an Annual Report for 176th Street LLC identifying PUCP as a member of 176th Street LLC. RCW 25.15.105(2) provides: “Information in an initial report or an annual report must be current as of the date the report is executed on behalf of the company.” An annual report is a document filed of public record with the intention that the document can be relied on by members of the public for information about ownership of the limited liability company.

Appellants assign error to Finding No. 6 asserting “there was no evidence presented at trial that Mr. Price was involved in the discussion for a purchase and sale of membership units in 176th Street LLC.” (*6/19/10 Opening Brief at p. 3, ¶ 2*). Appellants assert: “There was no evidence that Price had any involvement with the membership unit purchase and sale negotiations ... or had ever guaranteed any loans ...” (*6/19/10 Opening Brief at p. 39*). The idea appears to be that, even if the veil can be pierced, liability cannot be extended to Price.

Price's own testimony in Trial Ex. 43 was to the effect that he, together with Um, controlled the entity which Appellants contend was in control of 176th Street LLC. Both Price and Um participated in the only meeting between principals involving the negotiations for the MUSA/PSA. (TP 99-100). Mr. Wilson's testimony that Price did participate is actually uncontroverted in the record. Price negotiated the loan transactions with Mastro. (TP 297). Likewise, Price participated in the meeting where Mr. Racca was asked to renegotiate the purchase price in the PSA. (TP 299 and 329). Thus, there is ample evidence to conclude that Price and Um were purporting to act on behalf of PUCP.

On this evidence, any reasonable person would conclude that Price and Um were both represented as acting, and intended to act, on behalf of PUCP.

As to the second question, the undisputed fact of the matter is that the party identified in the MUSA as the purchaser of the 176th Street LLC membership units from Sunridge was never formed. It was "a non-existing entity." (6/18/10 *Opening Brief at p. 1*). Price acknowledged having created at least 28 development entities, including three different limited liability companies using the P & U Capital Partners name. Price testified that he was clearly aware that there was no such entity as PUCP – at any time. (Trial Exs. 43 and 44). Appellants themselves cite to the unambiguous testimony by both Price and Um that PUCP was never formed and never existed as a legal entity. (6/18/10 *Opening Brief at p. 13*).

Any other interpretation would be inconsistent with the purpose of the statute as enunciated in *Equipto Div. Aurora Equipment Co. v. Yarmouth*, 134 Wn.2d 356, 950 P.2d 451 (2009). What the case says is:

Reading RCW 23B.02.040 to require actual knowledge is consistent with the official statement of the Corporate Act Revision Committee, which states the statute acknowledges the equitable consideration of protecting persons who act 'with the good faith belief that a corporation existed.' Senate Journal at 2990.

134 Wn.2d at 371.

The simple fact of the matter is that, in this case, at the time of the repudiation of the PSA, Appellants had already engaged in a series of bad faith transactions the purpose of which was to skim equity out of the property at the expense of Respondent. Appellants were hoping to hide behind the limited liability company form to insulate themselves from the consequences of their own conduct. How it would further the purpose of the statute to allow them to claim immunity here is unknown.

In the context of a pre-formation transaction, if you read the statute as imposing no liability here, then an individual seeking the protection of the limited liability of the limited liability company form has no burden to confirm that the entity through which he purports to act is valid. Such an interpretation would render meaningless the requirement of formation requirements of RCW 25.15.070 that the filing of a certificate of formation is a condition precedent to formation of a limited liability company. The whole burden is shifted to the other side of the transaction. Is this consistent with the objective of the statute to ensure protection of persons who act with the good faith belief that a corporation existed? Should the

statute be construed to shift liability away from someone who is negligent with respect to the status of entities which limit his liability? Is this consistent with the principle in *Skagit State Bank v. Rasmussen*, 109 Wn.2d 377, 745 P.2d 37 (1987), that persons are charged with knowledge of the contents of documents that they sign?

With respect to the formation issue, Judge Stolz rightly concluded that “the failure to form P & U Capital Partners LLC with the State of Washington” would result in personal liability for Appellants under RCW 23B.02.040. Appellants asserted as defenses to this liability that: (1) the MUSA could be reformed to replace the “a non-existing entity” identified in the MUSA as the purchaser of the 176th Street LLC membership units from Sunridge, PUCP, with P&U I; and/or (2) Respondent’s claims for damages based on breach of the MUSA were barred under the doctrine of res judicata as a result of the dismissal with prejudice of the claims for damages against 176th Street LLC for breach of the PSA. If Judge Stolz was correct in her decision that Appellants had failed to meet their burden on either defense is correct, then it does not matter whether other bases for holding Price and Um personally liable exist.

C. The Scrivener’s Error/Reformation Issue.

A Court in equity may reform a contract to correct a scrivener’s error. *Geoghegan v. Dever*, 30 Wn.2d 877, 889, 194 P.2d 397 (1948). “A scrivener’s error occurs when the intention of the parties is identical at the time of the transaction but the written agreement errs in expressing that intention.” *Reynolds v. Farmers Ins. Co.*, 90 Wn. App. 880, 885, 960 P.2d

432 (1998). Typically, in a reformation case involving a mutual mistake, the plaintiff must prove his or her claims to a trier of fact by **clear, cogent and convincing evidence**. Nationwide Mutual v. Watson, 120 Wn.2d 178, 840 P.2d 851 (1992). Cavanaugh v. Brewington, 3 Wn. App. 757, 477 P.2d 644 (1970); Kaufmann v. Woodard, 24 Wn.2d 264, 270, 163 P.2d 606 (1945). The standard for reformation based on mutual mistake was stated in Keierleber v. Botting, 77 Wn.2d 711, 466 P.2d 141 (1970), as follows:

We have often reiterated and today reaffirm the rule that in order to justify the granting of reformation upon the ground of mistake, the mistake must have been mutual or common to the parties to the transaction, for a mistake on the part of one party alone is not relievable.... The party seeking reformation has the burden of proving the mutual mistake and must show clearly that the parties to the transaction have an identical intention as to the terms to be embodied in the deed or instrument and that the deed or instrument is materially at variance with that identical intention.

In this context, a mistake is a belief “not in accord with the facts.” Simonson v. Fendell, 101 Wn.2d 88, 91, 675 P.2d 1218 (1984). The mistake must be proved by clear, cogent and convincing evidence, and if doubts exist as to the parties’ intent, reformation is not appropriate. Akers v. Sinclair, 37 Wn.2d at 703, 22 P.2d 225 (1951).

However, a claim of scrivener’s error is often combined with a claim based on mutual mistake. Washington case law is not clear on whether the “clear, cogent and convincing” standard is applicable to both.

However:

The remedy of reformation is appropriate where, by reason of an unintentional mistake by a scrivener or draftsman, the written agreement does not accurately reflect the intent of

the parties. However, before the reformation of a written contract is warranted, it must be shown that the scrivener's product reflects something other than what was understood by both parties. Under the "doctrine of scrivener's error," the mistake of a scrivener in drafting a document may be reformed based upon parol evidence, provided the evidence is clear, precise, convincing and of most satisfactory character that the mistake has occurred and that the mistake does not reflect the intent of the parties.

The mistake of the scrivener is sometimes stated as though it were a separate ground for the reformation of an instrument, and the statement is also made in some cases that where the scrivener makes the mistake, the mistake need not be mutual. However, if the scrivener has made a mistake and neither of the parties realizes that the instrument does not express their true agreement, then the ground for reformation is the mutual mistake of the parties in believing that the instrument correctly embodies their true agreement. If the complaining party did not know of the mistake by the scrivener but the other party did know or deliberately procured the incorrect statement of the parties' agreement, then the ground for reformation is the mistake of one party coupled with the fraud or inequitable conduct of the other.

If a mutual mistake of the parties results from the mistake of the draftsman, it is immaterial, so far as reformation is concerned, as to which party employed the draftsman.

66 Am. Jur. 2d Reformation of Instruments § 19 (2010). It would appear that a clear cogent and convincing standard would be applicable irrespective of whether the claim is scrivener's error or mutual mistake. In either case, for the MUSA to be reformed, Appellants had the burden of demonstrating by clear, cogent and convincing evidence that it was the intention of the parties that P&U I rather than PUCP would be the purchaser.

Appellants contend this burden was met on the basis of several lines of evidence. First, at page 8 of their 6/18/10 Opening Brief, Appellants cite to testimony by Mr. Racca in which Mr. Racca was asked whether he understood “Sunridge was a 50 percent owner of P & U Capital I, LLC” to which Mr. Racca accurately answered: “No.” (*TP at 325*). How Mr. Racca’s accurate denial that Sunridge had an ownership in P&U I has anything to do with what entity was intended to be the purchaser of the units under the MUSA is a mystery. The ownership of P&U I was never at issue in the litigation – the issue was the ownership of 176th Street LLC. Mr. Racca was not asked about that.

Second, Appellants cite to testimony by Um to the effect that the “sole P&U-related or Price-and-Um-related entity that was involved in 176th Street was P&U Capital Partners I.” (*6/18/10 Opening Brief at p. 9*) (*Emphasis added*). However, Um executed at least eight documents, consisting of five Annual Reports and three Deeds of Trust, which explicitly conflict with this testimony. Based on these documents, at various times the members of 176th Street LLC included Um, Sunridge, PUCP and Mastro – but never P&U I. This does not include the three documents Um signed acknowledging that the purchaser of the units was in fact PUCP – not P&U I.

In this regard, this Court should simply ignore Um’s attempt to disclaim all of the various documents he executed which are contrary to the theory of the case he now asserts. As the Court noted in Skagit State Bank v. Rasmussen, 109 Wn.2d 377, 745 P.2d 37 (1987):

The relevant principles are summarized in *National Bank of Washington v. Equity Investors*, 81 Wn.2d 886, 912-13, 506 P.2d 20 (1973):

It is a general rule that a party to a contract which he has voluntarily signed will not be heard to declare that he did not read it, or was ignorant of its contents. *Perry v. Continental Ins. Co.*, 178 Wash. 24, 33 P.2d 661 (1934). One cannot, in the absence of fraud, deceit or coercion be heard to repudiate his own signature voluntarily and knowingly fixed to an instrument whose contents he was in law bound to understand.

Third, Appellants cite to testimony of Mr. Wilson that he understood that the units were to be sold to the other member of 176th Street LLC. However, Mr. Wilson also testified that the identification of the purchaser for the membership units was “solely up to” Price and Um and Respondent played no role in identifying PUCP as the purchaser. Mr. Wilson testified that the issue of who the purchaser would be was left to counsel to work out. (*See TP 99-100*). There was actually no testimony by Mr. Wilson that he knew who the other member of 176th Street LLC was. In light of the numerous conflicts in the testimony about who was that “other member” at the time of the MUSA transaction, Mr. Wilson’s testimony is simply meaningless.

The only thing that is clear here is that the issue of who was the member of the 176th Street LLC at the time of mutual execution of the MUSA is hopelessly confused. No reasonable person, on the basis of the evidence before Judge Stolz, could have ever concluded that the intent of the parties or the identity of the purchaser was established by clear, cogent and convincing evidence.

D. The Res Judicata /Collateral Estoppel Issue.

Respondent admits that Appellants have identified the correct standard of proof for the doctrine of res judicata with one two very material exceptions. First, the threshold requirement of res judicata is a valid and final judgment on the merits in a prior suit. *Ensley v. Pitcher*, 152 Wn.2d 891, 222 P.3d 99 (2009). The 2005 Lawsuit was settled, not resolved on the merits. (See *Trial Exs. 14 and 29*). Indeed, the whole basis for the claim of res judicata by Appellants is Mr. Mastro's condition that the lawsuit be dismissed as part of any deal with Respondent.

Second, Appellants state that: "Res judicata requires proof that the prior litigation and the current litigation are ***substantially*** identical in four respects." (6/18/10 *Opening Brief at p. 32*) (*Emphasis added*). The case law does not use the phraseology of "***substantially*** identical:"

Res judicata occurs when a prior judgment has a concurrence of identity in four respects with a subsequent action. There must be identity of (1) subject matter; (2) cause of action; (3) persons and parties; and (4) the quality of the persons for or against whom the claim is made. *Seattle First Nat'l Bank v. Kawachi*, 91 Wn.2d 223, 588 P.2d 725 (1978).

Rains v. State, 100 Wn.2d 663, 674 P.2d 165 (1983), cited by Appellants at page 32 of their 6/18/10 *Opening Brief* as identifying the standard for res judicata.

This case differs in key substantive respects from the 2005 Lawsuit: (a) different contract; (b) different causes of action; and (c) different parties.

1. Different Subject Matter.

Although many of the facts are the same, the subject matter is different here from that of the 2005 Lawsuit. The same subject matter is not necessarily implicated in cases involving the same facts. *See, Hayes v. City of Seattle*, 131 Wn.2d 706, 712, 934 P.2d 1179 (1997) (finding different subject matter in cases involving a master use permit where the initial case sought to nullify the city council decision and the second case sought damages); *Mellor v. Chamberlin*, 100 Wn.2d 643, 646, 673 P.2d 610 (1983) (finding different subject matter in cases involving the sale of property where the initial case sought to establish misrepresentation and the second case sought to establish a breach of the covenant of title); *Hisle v. Todd Pac. Shipyards*, 151 Wn.2d 853, 93 P.3d 108 (2004) (finding different subject matter in cases involving a collective bargaining agreement where the initial case challenged the validity of the agreement and the second case presumed the validity of the agreement but sought to apply the Minimum Wage Act to it).

The exclusive subject matter of the 2005 Lawsuit was enforcement of the PSA. In the 2005 Lawsuit, SBH – not Sunridge – specifically sought declaratory relief and an order of specific performance against 176th Street LLC for the sale of the property pursuant to the PSA.

In contrast, the subject matter of the present action relates to Appellants' breach of the MUSA and the damages arising from that breach. Unlike the claims of the 2005 Lawsuit, Appellants here did not fail to convey the property, but purposefully over-encumbered the property, using the proceeds from the loans secured by the property for their own purposes,

stripping the assets of 176th Street LLC and then forcing the property to be lost via a Deed in Lieu of Foreclosure. As in the cases cited above, the subject matter here differs indeed from the earlier litigation.

2. Different Causes of Action.

The causes of action are certainly different here. While identity of causes of action “cannot be determined precisely by mechanistic application of a simple test,” *Abramson v. University of Hawaii*, 594 F.2d 202 (9th Cir. 1979), the following criteria have been considered:

(1) [W]hether rights or interests established in the prior judgment would be destroyed or impaired by prosecution of the second action; (2) whether substantially the same evidence is presented in the two actions; (3) whether the two suits involve infringement of the same right; and (4) whether the two suits arise out of the same transactional nucleus of facts.

Costantini v. Trans World Airlines, 681 F.2d 1199, 1201-1202 (9th Cir.), cert. denied, 103 S.Ct. 570 (1982) (quoting *Harris v. Jacobs*, 621 F.2d 341, 343 (9th Cir. 1980)). See *Curtiss v. Crooks*, 190 Wn. 43, 53-54, 66 P.2d 1140 (1937); *Meder v. CCME Corp.*, 7 Wn. App. 801, 806, 502 P.2d 1252 (1972).

The present action does not run afoul of the rights established in the 2005 Lawsuit. Pursuant to dismissal of the 2005 Lawsuit with prejudice, 176th Street LLC was itself immune to any further claim that it specifically perform under the PSA. However, the present action was against Price and Um in their individual capacities for damages arising from their nefarious financing practices that worked to the prejudice of Respondent, and the related breach of the MUSA rather than the PSA. Proof of these claims

was substantially different from the proof necessary to enforce the PSA against 176th Street LLC. None of the evidence relating to the negotiations for the MUSA, the identity of the parties to the MUSA, Price's and Um's personal involvement, Price's and Um's guaranty liabilities or financing activities would have played a role in the 2005 Lawsuit.

The 2005 Lawsuit and the present action deal with the infringement of clearly different rights. The causes of action here are indeed different from those of the 2005 Lawsuit.

3. Different Persons and Parties.

“A judgment is not res judicata nor is one collaterally estopped by judgment in a later case if there is no identity or privity of parties in the same antagonistic relation as in the decided action.” *Owens v. Kuro*, 56 Wn.2d 564, 568, 354 P.2d 696 (1960); citing *Riblet v. Ideal Cement Co.*, 54 Wn.2d 779, 345 P.2d 173 (1959); *Rufener v. Scott*, 46 Wn.2d 240, 280 P.2d 253 (1955). “Privity within the meaning of the doctrine of res judicata is privity as it exists in relation to the subject matter of the litigation, and the rule is construed strictly to mean parties claiming under the same title.” *Owens*, 56 Wn.2d at 502; quoting *Sodak Distrib. Co. v. Wayne*, 77 S.D. 496, 502, 93 N.W.2d 791, 795 (S.D. 1958).

In the 2005 Lawsuit, the defendant was 176th Street LLC. In the present action, the defendants are Thomas Price and Hyun Um, individual members of an entity variously described as “P & U Capital Partners LLC” and “P & U Capital Partners I LLC,” as well as being members of several other related entities.

4. Quality of the Persons for or Against Whom the Claim is Made.

Here, it is easy to distinguish between the quality of the defendants and P & U Capital Partners LLC, on the one hand, and the separate and distinct entity 176th Street LLC on the other hand. In the 2005 Lawsuit, liability of 176th Street LLC was premised on its anticipated breach of the PSA. The potential liability of individuals Price and Um through P & U Capital Partners LLC falls “outside of this parameter.” *See, e.g., Brown v. Scott Paper Worldwide Company*, 98 Wn. App. 349, 364-65, 989 P.2d 1187 (1999). Liability here is premised on the breaches of the MUSA by the individual defendants acting in their own capacity or as agents of the fictitious entity P & U Capital Partners LLC.

Appellants also assert that the claims here would be barred under the doctrine of collateral estoppel. When a subsequent action is on a different claim, yet depends on issues which were determined in a prior action, the re-litigation of those issues is barred by collateral estoppel. *City of Arlington v. Cent. Puget Sound Growth Mgmt. Hearings Bd.*, 164 Wn.2d 768, 792, 193 P.3d 1077 (2008). Collateral estoppel requires:

(1) identical issues; (2) a final judgment on the merits; (3) the party against whom the plea is asserted must have been a party to or in privity with a party to the prior adjudication; and (4) application of the doctrine must not work an injustice on the party against whom the doctrine is to be applied.

In addition, the issue to be precluded must have been actually litigated and necessarily determined in the prior action.

City of Arlington, 164 Wn.2d at 792 (quoting *Shoemaker v. City of Bremerton*, 109 Wn.2d 504, 507-08, 745 P.2d 858 (1987)). The collateral estoppel argument fails for exactly the same reasons as the res judicata argument – no litigation on the merits.

E. Miscellaneous Issues:

1. The Consolidation Which Formed Respondent.

At page 19-20, Appellants assert that Respondent failed to establish that Respondent was a successor to Sunridge and SBH because Mr. Wilson’s testimony about the merger was without foundation. No objection to this testimony was made at trial and the objection was, therefore waived. *Payless Car Rental Sys., Inc. v. Draayer*, 43 Wn. App. 240, 243, 716 P.2d 929 (1986) (failure to object to a witness’s testimony on the basis of foundation waives the issue for appeal) (citing *Drake v. Ross*, 3 Wn. App. 884, 886-87, 478 P.2d 251 (1970)); and *Estate of Stalkup v. Vancouver Clinic, Inc. P.S.*, 145 Wn. App. 572, 187 P.3d 291 (2008).

If the objection had been made, it would not have been well taken. Mr. Wilson, in fact, testifies that he was employed by one of the entities involved in the consolidation/merger and that his job responsibilities changed as a result. Mr. Wilson obviously had personal knowledge of the events at issue.

However, the principal purpose of Appellants raising this issue is to assert that Mr. Wilson’s reference to “Sunridge Homes” instead of “Sunridge Homes, Inc.” is no different than a reference to “P & Capital Partners” instead of “P & U Capital Partners I.” The argument is simply facile.

There aren't multiple related entities whose names start with "Sunridge Homes." There are three different entities whose name starts with "P & U Capital Partners," respectively "P & U Capital Partners I," "P & U Capital Partners II" and "P & U Capital Partners III." (TP 295-296). Both "P & U Capital Partners I" and "P & U Capital Partners II" were formed to hold interests in properties where there were additional members unrelated to Price and Um. (*Id.*) Mr. Wilson's omission of the "Inc." does not have the same capacity for confusion.

2. Respondent's Additional Damages of \$1.3 Million.

Mr. Wilson's testimony on this subject is found at TP 193 and was neither objected to nor contested by Appellants. The backup documentation for this testimony was provided to Appellants' counsel in the form of proposed Trial Exs. 12 and 13. Appellants chose not to contest this testimony. This aspect of the appeal is frivolous.

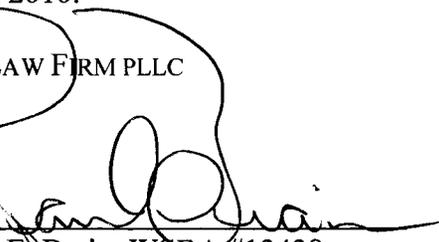
IV. CONCLUSION

Respondent is conversant with the general rule of drafting that you should: (1) tell them what you are going to tell them; (2) tell them; and (3) tell them what you told them. However, Respondent considers it unnecessary to continue to beat the dead horse.

The fact of the matter is that what happened in these transactions is clear. Whether or not Appellants conduct was fraudulent, and it arguably was, it was unquestionably dishonest and bad faith. Holding Appellants personally responsible is precisely what should have happened here. Respondent respectfully submits that this appeal should be denied.

DATED this 29th day of November, 2010.

BRAIN LAW FIRM PLLC

By: 

Paul E. Brain, WSBA #13438

Counsel for Respondent
Soundbuilt Northwest LLC

CERTIFICATE OF SERVICE

I hereby certify that I have this 29th day of November, 2010, served a true and correct copy of the foregoing document upon counsel of record, via the methods noted below, properly addressed as follows:

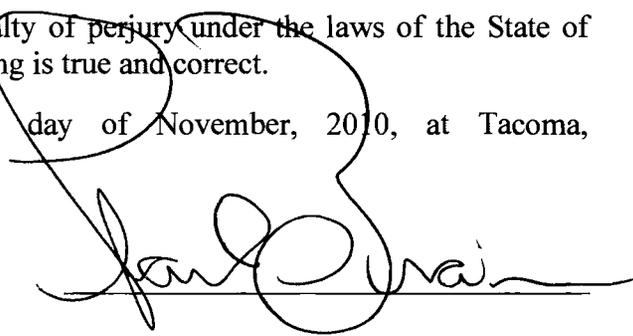
Attorneys for Appellants:

Salvador A. Mungia
John C. Guadnola
Gordon Thomas Honeywell LLP
1201 Pacific Avenue, Suite 2100
Tacoma, WA 98401

Hand Delivery
 U.S. Mail (first-class, postage prepaid)
 Facsimile
 Email

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

DATED this 29th day of November, 2010, at Tacoma, Washington.



COURT OF APPEALS
DIVISION II
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STATE OF WASHINGTON
BY _____
DEPUTY