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COURT OF APPEALS
DIVISION II

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STATE OF WASHINGTON

~~NO 42811-3-II~~
DEPUTY *SW*

COURT OF APPEALS, DIVISION II
OF THE STATE OF WASHINGTON

THE BERT KUTY REVOCABLE LIVING TRUST,
by its TRUSTEE, DAVID NAKANO,

Appellant (Plaintiff)

v.

GERRY and JOHN DOE MULLEN, husband and
wife; MICHAEL and JANE DOE MULLEN, husband
and wife; DC INC., d/b/a

NORTHWEST

PROPERTIES OF S.W. WASHINGTON, a
Washington corporation; COLUMBIA RIVER PROPERTIES, INC., a
Washington Corporation FREDERICK and JANE DOE LEMP, husband
and wife; NEW ENTERPRISE, LLC., a Washington LLC;

LE GRAND INVESTMENTS, L.L.C., a
Washington LLC; ROBERT and DANIELE
HAYES, husband and wife; RUSTY and JANE
DOE FIELDS, husband and wife; ENDEAVOR,
INC. d/b/a ENDEAVOR CONSULTANTS INC.;
JOHN and JANE DOES 1 – 10.

Respondents (Defendants)

APPELLANT'S REPLY BRIEF

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I. INTRODUCTION

This is a case arises from the sale of real property under circumstances that strongly suggest an organized equity-stripping fraud by a group of people acting in concert. Many of the key facts in this case were particularly within the knowledge of the defendants, including Robert and Daniele Hayes and Columbia River Properties, Inc. Despite this context, the Trial Court first dismissed the Hayes on summary judgment and then imposed CR 11 sanctions against the Plaintiff and his counsel. The Trial Court subsequently dismissed Columbia River Properties from the lawsuit, again on summary judgment, despite Columbia River Properties being a successor to a corporation the Trial Court ultimately determined to be liable.

All these decisions were made in error, and this Court should reverse and remand for discovery and trial, where the facts can come out and the credibility of witnesses and evidence may be weighed.

II. ARGUMENT

A. Organization

The opening brief covered multiple issues and parties, essentially divided in half with arguments as to the two respondents handled separately. This Reply will be similarly organized, except that the

arguments as to each Respondent will track the arguments and organization of the two Response briefs.

B. Statement of Fact

Respondents have quarreled with the Bert Kutty Trust's statement of fact. The Trust stands by it and does not change a word or a citation of it.

C. New Arguments

Respondent Hayes has asserted that the Trust has made new arguments. This is not the case, as will be seen below. However, if any argument is perceived as novel, it is nonetheless a proper supporting argument to the errors claimed on review. Moreover, RAP 2.5(a) is discretionary. State v. Ford, 137 Wn.2d 472, 477, 973 P.2d 452 (1999).

D. Reply to Hayes

1. The Dismissal of the Request for an Accounting was Error

The argument concerning an accounting is simple, both as a legal matter and as an arithmetic matter. Both Hayes and the Trust were secured parties, holding deeds of trust in the property. Those deeds of trust were to be paid from the proceeds of the foreclosure sale, satisfying Hayes' first position obligation first, then the Trust's second position obligation from any proceeds that were left. As a party to be paid from the proceeds of the sale who was disappointed in that design, the Trust is

entitled to an explanation and an accounting that describes how the proceeds of the sale were collected, valued, and distributed.

The Hayes purchased the property at the foreclosure sale by tendering in a note with the face value of \$238,000. That note contained no language limiting, reducing or otherwise changing its face value. Further, other potential bidders, including the Trust, understood that the bid price to beat the tender of the note had to exceed \$238,000. This is the equivalent of a cash purchase at \$238,000.

After the sale, obligations were discharged from the proceeds of the sale. The Hayes' obligation was discharged for a stated payment of \$40,000. This left a substantial amount of the proceeds of the sale unaccounted for. The Trust is entitled to have those proceeds accounted for and paid over to them to discharge their second position obligation.

The Hayes argue that the note that was discharged for \$40,000 was the same note that was tendered for \$238,000 as if this assertion means that the full proceeds were accounted for. It does not. Rather, the explanation shows that the foreclosure sale was conducted with the intent and effect of suppressing bidding by making a \$40,000 bid appear to be a \$238,000 bid. In such case, the sale was itself improper and could not form the basis of the summary judgment on appeal.

2. *The Unjust Enrichment Claim was Raised and Wrongfully Dismissed*

The Hayes argue that the Trust's unjust enrichment claim is being raised for the first time on appeal. This is not accurate. The unjust enrichment claim is essentially the same as the accounting claim, but with a different legal lens and perspective. The accounting claim looks at the payment side of the foreclosure sale and requests an explanation for how that payment was valued and distributed. The unjust enrichment claim looks at the distribution and requests an explanation for how a \$238,000 asset and tender was used to discharge a \$40,000 claim resulting in a windfall of nearly \$200,000 to the Hayes, even though other secured creditors were left unsatisfied. This is not a new claim. It is a second perspective on the fundamental claim about the distribution of the proceeds of the foreclosure sale.

3. *The Civil Conspiracy and Fraud Claims Were Dismissed With Prejudice in Error.*

The Trust's claim arises from the fraudulent transaction by which it was originally induced to sell the property to New Enterprise. One of the claims raised by the trust was for damages under a theory of "civil conspiracy." Civil conspiracy requires proof that (1) two or more people combined to accomplish an unlawful purpose or to accomplish an unlawful purpose by lawful means, and (2) the conspirators entered into an agreement

to accomplish the conspiracy. Newton Ins. Agency & Brokerage, Inc. v. Caledonian Ins. Group, Inc., 114 Wn. App. 151 at 160, 52 P.3d 30 (2002) (citing to Allstar Gas, Inc. v. Bechard, 100 Wn. App. 732 at 740, 998 P.2d 367 (2000)). This claim would provide for joint and several liability among all defendants shown to have been involved in the civil conspiracy, and each participant is liable for the actions of the others undertaken for the purpose of furthering the civil conspiracy. Sterling Business Forms, Inc. v. Thorpe, 82 Wn. App. 446 at 454, 918 P.2d 531 (1996). Such claims are very fact laden, both as to the events involved in the tortious concert of the participants and with regard to the participants themselves. As such, they are generally not appropriately resolved on summary judgment. Sterling, 82 Wn. App. at 454.

The Trust's fraud claim essentially follows from the civil conspiracy claim. This civil conspiracy involved an equity stripping fraud, so the participants in that scheme would be liable for the fraud.

The Hayes' entire argument against the appeal of the dismissal with prejudice of the fraud and civil conspiracy claims was that Mr. Hayes did not personally meet with any member of the Bert Kutty Trust. This argument is a perfect red herring in the context of a civil conspiracy. To establish that there are no facts on which Mr. Hayes could be liable, it is not enough that he did not personally meet with a member of the Trust. He is liable if a co-conspirator, acting to advance the civil conspiracy, did so. To establish that

he could not be liable, Mr. Hayes must show that he did not meet with or coordinate his actions with any of the other identified members of the equity stripping scheme. He has failed to make this showing. That makes him potentially liable.

As Mr. Hayes was a potentially liable party, the civil conspiracy and fraud claims against him should not have been dismissed with prejudice. Rather, the Trial Court should have allowed further discovery into those claims and should have allowed the Trust to assert or dismiss the claims based on the outcome of that discovery. The Trial Court erroneously denied the Trust this litigation opportunity, and this Court should reverse and remand to allow further discovery into Mr. Hayes's role in the equity stripping scheme.

4. *CR 11 Sanctions Should Not Have Been Imposed*

The Trial Court improperly imposed CR 11 sanctions in this case. Here, the Complaint was filed based on facts and inferences that were apparent after a pre-filing investigation conducted by counsel in the month and a half prior to filing. New facts and inferences arose during litigation, and the Trust's counsel attempted to respond to these appropriately, modifying the theories and arguments in the case and even seeking dismissal without prejudice of certain claims or theories. Despite this, and applying inaccurate hindsight, the Trial Court sanctioned the Trust and its

counsel under CR 11 and RCW 4.84.185. This sanction was in error and should be reversed.

Whether a case is frivolous requires essentially the same analysis under both CR 11 and RCW 4.84.185, except that RCW 4.84.185 requires an additional element (that the entire case be frivolous) that may not be required by CR 11 (there is some split in the authorities in this point). However, Hayes has not argued that the entire case was frivolous, and indeed parts of it continued to trial. Therefore, a sanction was not appropriate under RCW 4.84.185.

A sanction was also not appropriate under CR 11. Washington Courts look to Federal authority for guidance in applying CR 11, as Washington's rule is based on the Federal rule. Bryant v. Joseph Tree, Inc., 119 Wn. 2d 210 at 218-219, 829 P.2d 1099 (1992). The ordinary deference given to trial courts is tempered in the CR 11 context due to concerns about the rule being used to stifle zealous representation and the vitality of the adversary process. See In re Ronco, Inc., 838 F.2d 212 at 217-218 (7th Cir. 1988). A trial court's failure to engage in an appropriate degree of scrutiny or care in hearing a CR 11 motion is grounds for reversal and remand for reconsideration, if not for entry of an alternative ruling. Bryant 119 Wn. 2d at 222; Operating Engineers Pension Trust v. A-C Co., 859 F.2d 1336 at 1345 n. 13 (9th Cir. 1988).

The purpose behind CR 11 is to deter baseless filings and to curb abuses of the judicial system. Bryant, 119 Wn. 2d 210; Business Guides Inc. v. Chromatic Communications Enterprises, Inc., 498 U.S. 533, 112 L.Ed.2d 1140 at 1160, 111 S. Ct. 922 (1991). However, this deterrent impact and intent has the potential to stifle proper adversarial advocacy. Thus CR 11 “is an extraordinary remedy, one to be exercised with extreme caution.” Operating Engineers, 859 F.2d at 1344; Conn v. Borjorquez, 967 F.2d 1418 at 1421 (9th Cir. 1992). As a result, concern for the possible stifling consequences of a too swift and severe application of CR 11 requires that courts impose the “least severe sanction” adequate to accomplish the purpose of CR 11. Thomas v. Capital Security Services, Inc., 836 F.2d 866 at 878 (5th Cir. 1988) (*en banc*); Akin v. Q-L Investments, 959 F.2d 512 at 535 (5th Cir. 1992); Jackson v. Law Firm of O’Hara, Ruberg, et al., 875 F.2d 1224 at 1229 (6th Cir. 1989); Doering v. Union County Board of Chosen Freeholders, 857 F.2d 191 at 195 n. 3 (6th Cir. 1989).

Here, there is no indication that the Trial Court considered a less severe sanction than an imposition of a full shift of attorney’s fees. Further, it appears that the Trial Court misapplied CR 11 as a fee shifting provision rather than as a deterrent on future lapses. “Because deterrence is the primary goal, the minimum necessary to deter the sanctioned party

is the proper award, even if the amount does not fully compensate the moving party.” Danvers v. Danvers, 959 F.2d 601 at 605 (6th Cir. 1992).

Further, a trial court should consider the impact of a sanction under CR 11 on an attorney’s reputation. Golden Eagle Distributing Corp. v. Burroughs Corp., 801 F.2d 1531 at 1540 (9th Cir. 1986); Robinson v. National Cash Register, 808 F.2d 1119 at 1131 (5th Cir. 1987); Brown v. Federation of State Medical Boards of United States, 830 F.2d 1429 at 1437 (7th Cir. 1987); Conn v. Borjorquez, 967 F.2d 1418 at 1421 (9th Cir. 1992). This was not done here. As a direct result, this sanction has been referred to in a slanderous web posting that appears to have been posted by a member of this equity-stripping scheme in retaliation for an aggressive deposition taken in a parallel case. (See <http://www.shamscam.com/benjamin-d-cushman-attorney-a1878.html>).

An order imposing sanctions under CR 11 must also consider the impact of the sanctions on the vitality of the adversarial process. Bryant, 119 Wn. 2d 210 at 219; Townsend v. Holman Consulting Corp., 929 F.2d 1358 at 1363-64 (9th Cir. 1990); Mars Steel Corp v. Continental Bank N.A., 880 F.2d 932. The proper focus is in the conduct of the Plaintiff and counsel, not on the outcome of the case or the cost to the defendant. Mars Steel Corp, 880 F.2d 932 (citing Stephen B. Burbank, Rule 11 in Transition: The Report of the Third Circuit Task Force on Federal Rule of

Civil Procedure 11, 10-25 (American Judicature Society 1989). Here, the Trial Court focused exclusively, and impermissibly, on the outcome and especially on the cost of the litigation to the Hayes. The Court did not appear to consider, let alone rule on, the propriety of the prefiling investigation or the Complaint based on the facts and inferences available at the time of filing. At least, there is no record of any such consideration, despite it being the very essence of the proper application of CR 11.

Further, even if a party's pleading lacks a factual or legal basis, sanctions under CR 11 are not appropriate unless the trial court finds that the attorney who signed and filed the pleading failed to conduct a reasonable inquiry into the factual and legal basis of the claim. Bryant, 119 Wn. 2d 210 at 220; Miller v. Badgley, 51 Wn.App. 285 at 299-300; 753 P.2d 530 (1988). This standard is to be applied with reference to what was reasonably believed at the time the pleading, motion or legal memorandum was filed. Bryant, 119 Wn. 2d 210 at 220. Here, the Trial Court disregarded, rather than evaluated, both the prefiling investigation of counsel and the reasonable conclusions reached about the facts and inferences that supported the Complaint. This was reversible error. Bryant, 119 Wn. 2d 210 at 222.

Moreover, an order imposing CR 11 sanctions must adequately specify the reasons and basis for imposing the CR 11 sanctions, applying

the principles above and setting forth applicable conclusions and findings relevant to each. Vild v. Visconsi, 956 F.2d 560 at 571 (6th Cir. 1992); Szabo Food Service, Inc. v. Ceneen Corp., 823 F.2d 1073 at 1084 (7th Cir. 1987). Here, the Trial Court's order fails to contain the required findings or apply the proper analysis (as reflected in proper legal conclusions). Specifically, the order failed: (1) to inquire into or evaluate the prefiling investigation of the claims or the reasonableness of the factual inferences reached in that investigation; (2) to evaluate whether there was an adequate, lesser sanction that would have appropriate deterrent effect; (3) or consider impacts on the adversarial process or the attorney's reputation. Absent such considerations, this Court can and should freely exercise its own analysis and reverse the Trial Court's imposition of sanctions.

5. *Attorney's Fees Were Not Properly Supported by Evidence or Calculation*

Washington's Supreme Court sets forth the process by which trial judges may set reasonable attorneys' fees. Bowers v. Transamerica Title Ins. Co., 100 Wn.2d 581, 675 P.2d 193 (1983). This process, the "lodestar method," incorporates the twelve factors that are based on guidelines for private fee arrangements set forth in the Model Rules of Professional Conduct (1982). Bowers, 100 Wn.2d at 595-96. That process was not applied here, either in the briefing to the Trial Court or in the decision of the Trial Court. That defect is fatal to any fee award based on the amount

of fees incurred. Therefore, even if CR 11 were a fee shifting provision (as applied by the Trial Court – which it is not), the Trial Court could not award the fees it did based on the inadequate analysis of those fees in this record.

6. *Hayes is Not Entitled to Attorney’s Fees on Appeal*

Hayes was not entitled to fees below. Hayes continues to not be entitled to fees.

E. Reply to Columbia River Properties

1. *General Law on Successor Liability*

Generally when one corporation purchases the assets of another, the purchasing corporation does not, by mere fact of such purchase, become liable for the debts and liabilities of the purchased corporation. Martin v. Abbott Labs., 102 Wn.2d 581 at 609, 689 P.2d 368 (1984). However, there are well-established exceptions this is general principle. Successor liability will be imposed where any of the following factors apply: (1) the purchaser expressly or impliedly agrees to assume the liability; (2) the purchase is a de facto merger or consolidation; (3) the purchaser is a mere continuation of the purchased company; or (4) the transfer of assets is for the fraudulent purpose of escaping liability. Meisel v M & N Modern Hydraulic Press Co., 97 Wn.2d 403 at 405, 645 P.2d 689 (1982). Further, “[t]he question whether the corporate form should

be disregarded is a question of fact.” Truckweld Equip. Co. v. Olson, 26 Wn.App. 638 at 643, 618 P.2d 1017 (1980).

This case involves three of the four circumstances providing for successorship liability: (1) express or implied assumption of liability; (2) mere continuation of business after what is essentially just a name change; and (3) fraudulent transfer. Each of these alone supports a reversal of the Trial Court. Further, the Trial Court’s resolution of this key factual dispute without trial was also reversible error. This matter should be reversed and remanded to the Trial Court for trial on the Trust’s successorship liability theories.

2. *Columbia River Properties is a “Mere Continuation” of D.C. Inc.*

a. Common Identity of Officers, Directors and Shareholders

Columbia River Properties is a mere continuation of D.C. Inc. This Court has adopted a relatively simple test for determining whether one business entity is a “mere continuation” of another: (1) common identity of the officers, directors, and stockholders in the selling and purchasing companies and (2) whether there is sufficient consideration running to the seller. Eagle Pacific Ins. Co. v. Christensen Motor Yacht Corp., 85 Wn. App. 695, 706, 934 P.2d 715 (1997). (Division II follows this simple, two-part test, not the three-part test used by Division I and

applied by Columbia River Properties. This Court should follow its own test. However, the Trust's argument below will establish that successorship liability applies on either test.)

Columbia River Properties acknowledges that there is commonality between the shareholders, officers and directors of Columbia River Properties and those of D.C., Inc. Specifically, Mr. Fry, who is the main (perhaps the sole) shareholder, only director, and President of Columbia River Properties was also an officer in D.C. Inc. and had a derivative interest (through a secured debt retained upon an earlier sale by him of the business to the Mullens, the principal owners and officers of D.C. Inc.) in the shares of D.C. Inc.

Columbia River Properties argues that the requirement that there be overlap among the "officers, directors, and stockholders" sets forth a conjunctive test that requires that there be commonality in each category analyzed separately. This is a misinterpretation of the law. The commonality element of successorship liability is not a conjunctive test as asserted by Columbia River Properties. The words "officers, directors, and stockholders," rather than describing the elements of a test, define a set of beings that can then be scrutinized for commonality with a similar set of beings. Successorship liability may obtain if there is commonality between the sets.

Further, Columbia River Properties' argument that the Court must find a member of each of the three classes of people (officers, directors, and stockholders) in common between both companies for there to be successorship, does not comport with Washington State's current corporate law. Under current law, a corporation need not have any directors if its articles of incorporation so provide. RCW 23B.08.010(3). On Columbia River Properties' argument, a company that is the obvious and incontestable successor to another could simply avoid successorship liability by not having any directors.

The test is whether there is commonality, not whether there is complete or perfect correspondence, between the sets. There is commonality between sets if those sets have a member or members in common. These sets do, in the person of Mr. Fry.

b. Transfer of Substantially All D.C. Inc. Assets on Acquisition

Mr. Fry came to own the assets, contracts and other business of D.C. Inc. by levying against the shares when the Mullens defaulted on their purchase of the company. Essentially, Mr. Fry, who had retired and sold his real estate brokerage, took that brokerage back after the purchasers' defaults. The entire business transferred from Mr. Fry to the Mullens, and the entire business transferred back. Some contracts and employees may have been lost, as a result of ordinary business changes, of

the mismanagement of the business by the Mullens, or of changes precipitated by the changing ownership and management of the business during the transfers, but the core business essentially remained, and the purchaser brought little, if any, pre-existing business to the firm, relying entirely on the continuation of the old business.

Columbia River Properties argues that this substantial (almost entire) continuation of the business was the fortuitous result of Mr. Fry's marketing. However, that argument is belied by the lack of business other than continuation business upon the transfer. Further, as the business is a professional service business, the mere fact that the business's clients had an opportunity to stay or go is not dispositive. That is how professions operate. Clients have ultimate control over the choice to hire and retain a professional, and professionals cannot bind their clients to them as other businesses can bind their customers. This required the re-execution of management contracts. Far from showing that the business did not continue, the re-execution of the management contracts is the manner in which a property management business could continue.

c. Failure to Provide Adequate Consideration in Purchase

Similarly, Columbia River Properties attempts to turn its failure to pay adequate consideration into an argument against continuing liability. Columbia River Property acknowledges that Mr. Fry paid a *de minimis*

amount for D.C. Inc., stating that the amount paid was for two filing cabinets. That fact, far from defeating successorship liability, establishes it.

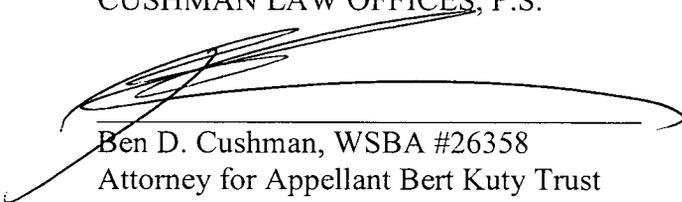
Mr. Fry obtained the assets, the contracts, and the customers of D.C. Inc. In exchange, he paid for two filing cabinets. Again, Mr. Fry, who had sold the business to the Mullens, took it back when the Mullens defaulted on their purchase, and paid little to nothing in doing so. This is a failure to pay adequate consideration.

III. CONCLUSION

Bert Kutty Trust deserves to have its claims tried by the trier of fact after a full and proper discovery process, not dismissed on summary judgment. The error of this dismissal should not be compounded by the further injury of allowing the CR 11 sanction improperly imposed by the Trial Court to stand. This Court should reverse and remand the case for trial.

Respectfully submitted this 27th day of June, 2012.

CUSHMAN LAW OFFICES, P.S.



Ben D. Cushman, WSBA #26358
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CERTIFICATE OF SERVICE

The undersigned declares under penalty of perjury as follows:

On June 27, 2012, I caused the foregoing document to be filed with this Court and emailed and mailed to the parties as listed below:

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