

FILED

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DIVISION III
STATE OF WASHINGTON
By _____

No. 291413

IN THE COURT OF APPEALS
STATE OF WASHINGTON
DIVISION III

SHOU SHIA WANG, *et al.*
Respondents/cross-appellants

v.

TA CHI, INC., *et al.*
Appellants/Cross-Respondents

APPELLANTS' REPLY AND RESPONSE BRIEF

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Respondents Ta Chi, Inc. and Lotus
Fruit Packing, Inc.

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I. INTRODUCTION

Wang wants Ta Chi to pay her for being disloyal. That is the gist of the three issues that she appeals. In her first point of error, she claims to have owed no duties to Ta Chi's subsidiary, Lotus. Even though she controlled its assets and specifically advised it to pay \$1 million — a grossly inflated price — for equipment that she secretly owned. Next she contends that her decision to cover up a lawsuit — a lawsuit brought on by an earlier breach of loyalty — and have Ta Chi pay over \$200,000 in litigation costs was a reasonable exercise of business judgment. Finally, despite roughly \$500,000 in judgments against her and her entities, Wang claims entitlement to indemnity for being sued. As Appellants will discuss in Section III, none of Wang's points of error has merit.

But before addressing the issues Wang appeals, Appellants will reply to Wang's response to the issues they raised.

II. REPLY

A. Wang's Deposition Testimony Should Have Been Admitted

At trial Ta Chi offered into evidence and asked that the court review designations from Wang's pretrial depositions. Wang claimed that was unfair. The trial court did not rule on whether the designations were admitted or excluded but on the last day of trial proposed a compromise.

I don't think as a general rule when the witness is here to testify that depositions are generally used. On the other hand, we don't

have a jury and we're going to do, as I understand it, post trial closing briefs, et cetera. If you believe there's something in Ms. Wang's deposition that did not come out at trial, you point me to that. . . I will then decide at that time whether to review that and probably would review it.

* * *

You do the reading. So if you think there's something in there that did not occur at trial that the Court should review, then point that out to me. Mr. Siderius will have the counter, the last opportunity, and you can identify that, address why I should or should not review it.

(RP 1536-37) Three months later, at a post-trial hearing on the proposed findings and conclusions, the court excluded the designations from Wang's depositions because "she was here in trial and testified."¹ (April 2010 Post-trial Hearing at 16)

The trial court's rationale for excluding Wang's testimony was legally incorrect. Wang's testimony was admissible at trial for any purpose. Ta Chi and Lotus offered it into evidence before, during, and — at the court's suggestion — after trial. It should have been admitted. CR 32(a)(2) (deposition of party or party representative may be used by the adverse party for any purpose); *Young v. Liddington*, 50 Wn.2d 78, 79, 309 P.2d 761 (1957).

¹ Wang cites ER 403 as being a basis for the court's decision. But it was not. ER 403 allows the exclusion of relevant evidence if its potential prejudice outweighs its relevance or if it is a waste of the jury's time. The case discussing ER 403 cited by Wang was a jury trial. The question in that case was whether the evidence was too prejudicial. Neither ER 403 nor the case cited has any relevance to the trial court's decision here.

Moreover, because the judge said attaching the designations to post-trial briefs was a sufficient way to present the testimony, which had already been offered at that point, Ta Chi did not go back through all of its designations to ensure the testimony was read into the record by a live witness. Ta Chi cannot be faulted for the procedure the trial court suggested. Wang asserts the testimony was not shown to matter in the outcome. But Appellants cited it in their opening brief for a number of points.²

B. Burdens of Proof on Interested Transactions

Once a principal establishes that a fiduciary relationship existed and that a specific transaction involved self-dealing, the burden shifts to the disloyal agent to prove: (i) that she disclosed her interest in the transaction, (ii) that she disclosed all potentially material facts about transaction, and (iii) that the transaction was fair³ to the principal.⁴ If the agent fails to prove both full disclosure and fairness, the transaction is a breach of her duty of loyalty and may be rescinded. Alternatively, the principal can recover both the losses it sustained from the transaction and

² See Appellants' Br. at 7, 9, 11-12, 17, 34-35 citing CP 1379, 1380-81, 1384-87, 1404, 1426-27, 1434-35, 1447-48, 1450.

³ An agent's failure to make full disclosure makes the transaction inherently unfair. *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wn.2d 375, 382, 391 P.3d 979 (1964)

⁴ RESTATEMENT (SECOND) AGENCY § 389 *cmt. d and e* (1958); *Mersky v. Multiple Listing Bureau of Olympia, Inc.*, 73 Wn.2d 225, 229, 435 P.2d 897 (1968); *Moon v. Phipps*, 67 Wn.2d 948, 954, 411 P.2d 157 (1966); *Hayes Oyster Co.*, 64 Wn.2d at 382.

the profit that the agent received. RESTATEMENT (SECOND) AGENCY §§ 387, 390, 403, 407 (1958).

The principal has the burden of proving its loss and the gross revenue or gain received by the agent from the transaction. But the agent has the burden of proving any costs incurred that should be deducted from its gross revenue to arrive at its profit. *See, e.g., C&B Sales & Serv., Inc. v. McDonald*, 177 F.3d 384 (5th Cir. 1999); *Gomez v. Bicknell*, 302 A.D.2d 107, 114-15, 756 N.Y.S.2d 209 (2002); RESTATEMENT (SECOND) AGENCY § 403 *cmt c* (1958).

C. The Limitations Period Barred Wang's Loan Claims

Whether a claim is barred by the statute of limitations and when the limitations period begins are issues of law reviewed *de novo*. *Breuer v. Douglas P. Presta, D.P.M.*, 148 Wn. App. 470, 476-77, 200 P.3d 724 (2009); *Canatella v. Van de Kamp*, 486 F.3d 1128, 1132 (9th Cir. 2007).⁵

To decide the limitations issue, the trial court had to answer three questions as to each loan claim. It had to determine (1) what the limitations period was; (2) when it began; and (3) whether it was ever stopped or reset by Ta Chi. The trial court correctly answered the first question (CP 417) but not the last two.

⁵ At trial Wang brought claims based on 15 separate loans that she made between April 2002 and May 2006. Ten were made prior to December 31, 2004, and five were made after. (CP 426; Ex. 160(M))

1. Wang breached her duty of loyalty

Wang does not appeal the trial court's finding that she was Ta Chi's agent and fiduciary. (CP 1775 at ¶ 46; CP 1788 at ¶¶ 132-133; CP 1797 at ¶ 201; CP 1798 at ¶ 210) In fact, in her response brief, Wang admits that as Ta Chi's manager she owed the corporation a duty of loyalty. (Response Br. at 28) Because she was a fiduciary, Wang's loans to the company were self-dealing transactions. *Hein v. Gravelle Farmers' Elevator Co.*, 164 Wash. 309, 2 P.2d 741, 78 A.L.R. 631 (1931). They required fairness and full disclosure.

Wang disclosed certain information about the loans but intentionally concealed her identity as lender, misrepresenting that the loans were from third parties. (CP 1776-77 ¶ 52; Ex. 105; RP 495-496, 504-508) This concealment was a breach of her fiduciary duty of loyalty. RESTATEMENT (SECOND) AGENCY § 389 (1958). The concealment lasted six years, until Wang sued Ta Chi in January 2008. (CP 1-9; CP 1776 ¶ 52; CP 1779 ¶ 69; 1781 ¶ 87) Each time Wang communicated about the loans during those six years she committed a new breach of loyalty. *Oates v. Taylor*, 31 Wn.2d 898, 902-03, 199 P.2d 924 (1948); RESTATEMENT (THIRD) AGENCY § 8.11 *cmt. b* (2006).

2. The limitations period began on the date of each loan

Wang's transfers to Ta Chi were demand loans. (CP 1797 ¶ 196)

Wang told Ta Chi that the loans were temporary and that the fictional third-parties may need to be repaid at any time. (CP 1779 ¶ 70) Given those two findings, which Wang does not dispute on appeal, the limitations period on each claim began to run on the day the loan was made. *Hopper v. Hemphill*, 19 Wn. App. 334, 336, 575 P.2d 746 (1978); *Wallace v. Kuehner*, 111 Wn. App. 809, 819, 46 P.3d 823 (2002).

Nevertheless, the trial court concluded otherwise, erroneously applying an exception to the rule for demand loans. (CP 1797 ¶ 197) This exception holds that when a creditor and a debtor agree, at the time that the loan is made, that demand for repayment will be delayed for some period of time, the limitations period does not begin to run immediately. But, for this exception to apply, the parties to the loan must intend "at the time the contract was made" for there to be a delay in the lender's demand for repayment so that "speedy demand would manifestly violate [the parties'] intent". *Cochran v. Cochran*, 133 Wash. 415, 418, 233 P. 918 (1925); *see also Wallace*, 111 Wn. App. at 819 (exception applies "where the parties intend a delay in repayment"); *Nilson v. Castle Rock Sch. Dist.*, 88 Wn. App. 627, 630, 945 P.2d 765 (1997) ("an exception to the rule exists when, at the time of contracting, the parties contemplated delay in

making the demand”). Here there was no evidence of such mutual intent at the time the loans were made. In fact, the evidence showed, and the court found, just the opposite. (CP 1779 ¶ 70) Wang admitted that when she made the loans, she thought they were temporary. (RP 508, 538) She told Ta Chi they were temporary. (Ex. 105) And she listed the loans as demand loans on her personal financial statements. (Exs. 304-306)

Despite this evidence, the trial court applied the exception based on Wang’s testimony that she eventually realized that the loans would not be repaid quickly. But no evidence was presented that Wang communicated this change of heart to Ta Chi or that she and Ta Chi agreed to change the repayment terms. Indeed, given the other facts found by the court, such a modification would have been impossible because Wang was still concealing her identity as lender.

By mistakenly applying the exception, the trial court found in essence that Wang could unilaterally change the limitations periods on her loans without telling Ta Chi that she was its creditor. But if a fiduciary extended the limitations period on her claims without full prior disclosure of the act and explanation of the legal effect that too would be a breach of loyalty. *Cf. Hein v. Gravelle Farmers’ Elevator Co.*, 164 Wash. 309, 2 P.2d 741 (1931); *Kane v. Klos*, 50 Wn.2d 778, 785, 314 P.2d 672 (1957)

(fiduciary must disclose legal consequences of transaction for full disclosure to be found).

The court's findings about Wang's internal expectations on when she would be repaid are irrelevant to when the limitations period began. If creditors — particularly self-dealing creditors — could unilaterally delay the running of the limitations period by telling the debtor one thing but internally thinking the opposite, statutes of limitation would become meaningless. There is no Washington policy, statute, or court decision that supports such fundamentally flawed conclusion. The limitations period on each loan claim began on the date of the loan and ended three years later.

3. Ta Chi could not ratify the loans

A principal cannot ratify a transaction with its agent unless the agent discloses her interest in the transaction and provides the principal with all material facts. *Cogan v. Kidder, Mathews & Segner, Inc.*, 97 Wn.2d 658, 663, 648 P.2d 875 (1982); RESTATEMENT (SECOND) AGENCY § 381 *cmt. d* (1958). The trial court found that Wang concealed her identity as lender from Ta Chi for six years. (CP 1776-77 ¶ 52; CP 1179 ¶ 69; CP 1781 ¶ 87) Ratification was impossible.

Nevertheless, Wang asserted that while Ta Chi did not know that Wang was its creditor, it did know that it had borrowed money and that

the money had been spent. (CP 1778-1779 ¶¶ 65-66) The trial court erroneously found that that was enough for ratification. (CP 1797 ¶¶ 198-199) But instead of supporting ratification, those findings establish, as a matter of law, that ratification was impossible.

“The acceptance or retention of benefits derived from an agent’s unauthorized act does not amount to ratification of such act if the principal, in accepting such proceeds or benefits, does not have knowledge of all the material facts surrounding the transaction.” *Consumers Ins. Co., v. Cimoch*, 69 Wn. App. 313, 323, 848 P.2d 763 (1993) (quoting 30 Am. Jur. 2d., Agency §195 (1986)); *Thola v. Henschell*, 140 Wn. App. 70, 86, 164 P.3d 524 (2007). Two Washington cases highlight the link between disclosure and ratification. In the first case, *Hayes Oyster Co.*,⁶ the Supreme Court rejected the agent’s ratification argument because he had concealed his interest in the transaction, just as Wang did here. *Id.* at 385. In the second case, *Poweroil Manufacturing Co.*,⁷ the court accepted the ratification defense because in that case the defendants had fully disclosed all material facts and invited comment on the interested transaction. Ratification and rescission are two sides of the same coin. If a transaction has been ratified, it cannot be rescinded. If it can be rescinded, it has not

⁶ 64 Wn.2d 375, 385-86, 391 P.2d 979 (1964).

⁷ *Poweroil Mfg. v. Carstensen*, 69 Wn.2d 673, 678-80, 419 P.2d 793 (1966).

been ratified. Wang's loans were not approved after full disclosure that she was the lender. Therefore, they were never ratified.

4. Wang's breach of loyalty was material

Wang cites the trial court's reconsideration opinion in arguing that her identity as lender was immaterial to Ta Chi. Thus, the argument goes, her non-disclosure did not prevent Ta Chi from ratifying the loans. The problem with this argument — and the trial court's reasoning — is that an agent's self-dealing is a fraud in law⁸; it is always material.

It is of no consequence . . . that the [agent] may be able to show that the breach of his duty of . . . loyalty did not involve intentional or deliberate fraud, or did not result in injury to the principal, or did not materially affect the principal's ultimate decision in the transaction. The rule and the available remedies, instead, are designed as much to prevent fraud as to redress it, and foilow directly upon the heels of the broker's deliberate or innocent failure to timely and fully disclose to his principal the fact [of the agent's interest].

Mersky, 73 Wn.2d at 231 (reversing lower court decision that agent's failure to disclose interest was immaterial). Just as she violated her duty of loyalty to Lotus by concealing her interest in the Summer Fruit transaction, Wang violated her duty of loyalty to Ta Chi by concealing her interest as counterparty on the loans. While the trial court clearly viewed

⁸ *Mersky v. Multiple Listing Bureau of Olympia, Inc.*, 73 Wn.2d 225, 231, 437 P.2d 897 (1968); *Cogan v. Kidder, Mathews & Segner, Inc.*, 24 Wn. App. 232, 240, 600 P.2d 655, (1979), *order modified*, 97 Wn.2d 658, 648 P.2d 875 (1982).

the Summer Fruit transaction as more unfair,⁹ both transactions involved a fraud in law¹⁰ because both involved an undisclosed adverse interest by an agent. Self-dealing is self-dealing, regardless of motive and regardless of fairness.

To hold that a breach of loyalty can be immaterial is to hold that an agent does not have a fiduciary duty to disclose her interest in a transaction. That is simply not the law of this state. *See, e.g., Cogan v. Kidder, Mathews & Segner, Inc.*, 97 Wn.2d 658, 662, 648 P.2d 875 (1982) (holding that the disclosure of an agent's conflicting interest is always required, regardless of whether it affected the principal's ultimate decision to enter into the transaction).

The trial court's statement that Wang's identity did not matter was also at odds with the undisputed facts and the court's own findings. There was undisputed evidence that if Wang was going to invest in Ta Chi, Ta Chi wanted the investment to be an equity investment and not a loan. (RP 874, 902-904; Ex. 118; CP 1781 at ¶ 87). At the March 2007 meeting, Ta Chi and Wang resolved that Wang would assume responsibility for paying

⁹ Wang took care of herself on the loans too. She secretly paid herself \$170,000 in interest over four years (Ex. 160(M)) and gradually increased the interest rate on the loans without telling Ta Chi. (RP 533-38; CP 1380-81, 1386-87; Exs. 162 and 164).

¹⁰ In a fraud claim, materiality of the misrepresented fact is an element of the plaintiff's claim. *Beckendorf v. Beckendorf*, 76 Wn.2d 457, 462, 457 P.2d 603 (1969). In a breach of fiduciary duty claim, an agent's failure to disclose her interest is fraud in law.

off the loans, which Ta Chi still believed were from third-parties, and in return she would obtain an equity interest in Ta Chi. (CP 1781 ¶ 87) That finding shows that Ta Chi preferred an investment by Wang — its manager — to be equity and not debt. Had it known she had money to invest in 2002, Ta Chi would have insisted the investment be equity and not debt. (RP 874) If Wang was not willing to risk her own money, the shareholders would have lost confidence in her statements about how profitable the orchard would become. (Ex. 108) Through her misrepresentations, Wang avoided having Ta Chi ask her to become a shareholder.

5. Equitable estoppel does not apply

Wang argues that the trial court properly concluded that Ta Chi was estopped from asserting the statute of limitations defense. But to establish estoppel, Wang would have had to prove that Ta Chi fraudulently or inequitably invited her to delay commencing suit against it until the applicable limitations period had run on her claims. *Del Guzzi Constr. Co. v. Global Nw., Ltd.*, 105 Wn.2d 878, 885, 719 P.2d 120 (1986). As the trial court found, however, Ta Chi had no knowledge that Wang had loaned it money until she sued in 2008. (CP 1779 ¶ 69) As a matter of law (and common sense) Ta Chi could not have fraudulently or inequitably induced Wang to delay commencing suit when it did not even

know she had a claim. Wang also did not prove any of the other elements necessary for estoppel.

Wang has also argued that Ta Chi's use of the borrowed funds — which Wang spent on Ta Chi's behalf — estopped Ta Chi from asserting the limitations defense. But there is no legal support for such a theory. If use of borrowed funds amounted to estoppel, then borrowers would never be able to assert a limitations defense, which is plainly not the law. *See, e.g., Nat'l Bank of Commerce v. Preston*, 16 Wn. App. 678, 558 P.2d 1372 (1977).

6. Wang concedes Ta Chi did not acknowledge a debt to her
Ta Chi argued below and on appeal that it never reset the limitations periods on Wang's loan claims by making a voluntarily partial payment or by acknowledging the debts in a signed writing. (Opening Br. at 33-34) The trial court made no findings or conclusions about these two issues, on which Wang had the burden of proof. *Grissom v. Bull*, 195 Wash. 97, 79 P.2d 971 (1938). By not addressing these arguments in her response, Wang concedes that Ta Chi never acknowledged owing her money, either by voluntarily payment or signed writing. As with Wang's estoppel argument, any argument that Ta Chi acknowledged the loans

cannot survive in the face of the trial court's conclusion that Ta Chi did not know that Wang had lent it money.¹¹

D. Wang Had an Interest in Lotus and Ta Chi Expanding the Building and Purchasing the Apple Line

Wang's April 2006 proposal for Ta Chi to vertically integrate (RP 673-675; CP 1772 ¶ 28; CP 1782 ¶ 94) consisted of four steps: (1) the purchase of Jong Seng's storage facility; (2) the expansion of the facility to house packing lines; (3) the purchase of a new apple packing line; and (4) the purchase of Summer Fruit's cherry line. (Ex. 112; RP 673) Wang testified that these four steps only made sense if they were taken together (Ex. 112; RP 656-657; CP 1447-1448) and based on her recommendation Ta Chi and Lotus took all four steps. Two of the four steps put money directly into Wang's pocket. (CP 1485) The trial court found that as to one of the steps Wang breached her duty of Loyalty.

But for Wang to realize a profit on that disloyal transaction, she had to ensure that Ta Chi or Lotus completed the other three. She did that by spending millions of their dollars improving the storage facility and

¹¹ The trial court mixed the issue of ratification and acknowledgment. If Ta Chi ratified the loans by simply knowing that they existed and that the money had been spent, then the first six loans were ratified when Ta Chi received Wang's 2002 year end report. In that report she told Ta Chi that the loans had been made and that the money had already been spent. (Ex. 105) Of course, she also lied about who the loans were from. Assuming, for the sake of argument, that the lie did not prevent Ta Chi's ratification, then the first six loans were ratified in December 2002. The statute of limitations would still have run in December 2005.

buying an apple line *before* Ta Chi actually owned the facility. (Exs. 160(R)-(W), 186, 157)

Wang cites no authority for the proposition that an agent has to be a party to a transaction before a duty to disclose an interest arises. If any material benefit will flow to the agent from the transaction, however indirect, it is still a breach not to disclose it and obtain consent of the principal. Here, Wang stood to gain hundreds of thousands of dollars in profit from the inflated cherry line sale. She had an interest in making sure the facility was purchased and expanded to house the cherry line she was selling.

E. Wang was Ta Chi's Agent in the Jong Seng Transaction

Wang was Ta Chi's agent and fiduciary from 2001 to October 2007. (CP 1775 ¶ 46; CP 1788 ¶ 132; CP 1789 ¶ 135; CP 1797 ¶ 201; Response Br. at 28) During that time, she had dominion and control over Ta Chi's money and other assets and *carte blanche* authority to use them in the best interest of the corporation. (CP 1797 ¶ 201)

Nevertheless, the trial court concluded that because Ta Chi knew that Wang managed Jong Seng and "knew or should have known" that she owned Jong Seng, Wang was not Ta Chi's agent for that transaction. (CP 1790-91 ¶ 149; CP 1798 ¶ 207) However, those two facts did not preclude a finding that Wang was also Ta Chi's agent. The trial court's treatment

of this issue rests on the flawed assumption that Wang's agency for Jong Seng precluded her agency for Ta Chi. But dual agencies are common; one does not preclude the other. *See, e.g.*, RESTATEMENT (SECOND) AGENCY § 390 (1958); *Cogan v. Kidder, Mathews & Segner, Inc.*, 97 Wn.2d 658, 648 P.2d 875 (1982).

There was overwhelming evidence that Wang's agency for Ta Chi included her representation of Ta Chi in the transaction with Jong Seng. Indeed, before trial Wang stipulated that she "helped negotiate the purchase of the . . . storage facility" at a "price below its appraised value." (CP 669 ¶ 31) And the trial court acknowledged that she was Ta Chi's advisor regarding the transaction. (CP 1792 ¶ 160)

In addition, at the time of the transaction, Wang was Ta Chi's paid general manager and general fiduciary. Five days before the transaction, she signed Ta Chi's federal tax return as its Secretary. (Ex. 246) Wang identified the facility as a potential asset for Ta Chi to purchase and ultimately urged Ta Chi to buy it. (Ex. 112; CP 1772 ¶ 28) She counseled Ta Chi to look at other facilities and dealt with other potential sellers on its behalf. (Exs. 113, 189, 190, 192) She provided Ta Chi with inside information about Jong Seng that — had it actually been true — would have benefitted Ta Chi at Jong Seng's expense. (RP 699-704; Ex. 113) She helped Ta Chi obtain a bank loan to finance the purchase of the Jong

Seng facility. (Ex. 148, 157; RP 900) She said she was “in between the parties.” (Ex. 113) Wang said that at all times she was acting in the best interest of Ta Chi. (RP 436-437) Mrs. Shen testified (1) that Wang was Ta Chi’s agent; (2) that Wang read the English contract to her — Mrs. Shen does not read English — before she signed it; and (3) that Wang told her that she would get the best price possible from Jong Seng. (RP 889-890; 901-903)

Wang was plainly Ta Chi’s agent for purposes of the Jong Seng transaction. Her agency for Jong Seng did not negate her agency for Ta Chi. The trial court erred in concluding it did.

Wang argues that there was no evidence the facility was a poor investment. (REsp. Br. at 29-30) But there was strong evidence that Jong Seng’s revenues were declining and Fugachee’s demand for storage services was diminishing. (CP 1487; CP 1376-77; RP 658-669)

F. Ta Chi Sought Rescission in January 2009

Wang admits that Ta Chi requested rescission of the Jong Seng transaction in January 2009 and not, as the court found, on the eve of trial. (Resp. Br. at 24) Whether the 11-month difference between January and December 2009 affected the trial court’s decision that Ta Chi waited too long to request rescission is unclear. If Wang was Ta Chi’s agent for purposes of the Jong Seng transaction, the issue of whether Ta Chi waited

too long to request rescission must be remanded so that the trial court can decide the issue using the proper interval.

G. Wang's Testimony Could not Contradict the Express Terms of the Jong Seng Contract

Ta Chi does not argue that Wang's statements should have been excluded from evidence.¹² Rather it appeals the trial court's conclusion that her statements mattered in determining the rights and obligations under the contract between Ta Chi and Jong Seng. In the contract Jong Seng promised to deliver 18,000 bins to Ta Chi. (Ex. 183) The trial court concluded that Jong Seng did not have to honor that promise based on Wang's testimony that there was no real promise to deliver bins. The trial court relied on Wang's testimony and found that Jong Seng's failure to deliver the bins was not a breach, reading the promise out of the contract. That was error.

When interpreting a contract, parol evidence¹³ may be used "for the purpose of ascertaining the intention of the parties and properly construing the writing" in order to "elucidat[e] the meaning of the words employed." *Berg v. Hudesman*, 115 Wn.2d 657, 669, 801 P.2d 222

¹² *Fleetham v. Schneekloth*, 52 Wn.2d 176, 179, 324 P.2d 429 (1958) ("The parol evidence rule is not a rule of evidence, but one of substantive law. Even though evidence which falls within the inhibition of the rule is admitted without objection, it is not competent and cannot be considered as having probative value"); *City Nat'l Bank v. Molitor*, 63 Wn.2d 737, 388 P.2d 936 (1964).

¹³ The term parol evidence means evidence of oral statements. BLACK'S LAW DICTIONARY 598 (8th Ed. 2004)

(1990)(quoting *J.W. Seavey Hop Corp. v. Pollock*, 20 Wn.2d 337, 348-49, 147 P.2d 310 (1944)). In other words, it may be used to “aid[] in the interpretation of what is in the instrument, and not for the purpose of showing intention independent of the instrument.” *Id.* Regardless of whether a contract is fully or partially integrated,¹⁴ parol evidence may not be used to establish a term that is directly at odds with a term contained in the written instrument. *Berg*, 115 Wn.2d at 670. Wang’s testimony was not giving meaning to any words in the written agreement but was attempting to show intent in direct contradiction to an express promise contained in the agreement. It was error for the trial court to rely on it. *Bort v. Parker*, 110 Wn. App. 561, 573-74, 42 P.3d 980 (2002); *State Farm Mut. Auto. Ins. Co. v. Avery*, 114 Wn. App. 299, 311, 57 P.3d 300 (2002).

H. Ta Chi’s Damages Equaled the Market Value of the Bins

Wang and Jong Seng assert that once the contract price was listed at \$0 in the addendum, Ta Chi lost its contractual right to the bins. The language of the addendum makes clear that is not the case. (Ex. 9(2)(B)) Moreover, there is no legal support for that position or the trial court’s conclusion that Ta Chi was not damaged by Jong Seng’s failure to deliver.

¹⁴ Wang did not argue, and the court did not find, that the Jong Seng contract was not fully integrated.

Ta Chi presented uncontested evidence establishing the market value of the bins. (RP 735-736; Exs. 182 and 187) It was not disputed that Ta Chi paid the full \$2.5 million contract price.¹⁵ (Exs. 186, 157)

Jong Seng's position does not jibe with fundamental principles of contract law. If the contract price for a good were deemed to be a cap on its value for purposes of damages in a breach of contract case, then there would never be damages for failure to deliver. The best that a buyer could receive would be a return of the contract price, assuming it had already been paid. But contract damages are intended to give the non-breaching party the benefit of its bargain. *Pettaway v. Commercial Auto. Serv., Inc.*, 49 Wn.2d 650, 655, 306 P.2d 219 (1957); *Mason v. Mortgage Am., Inc.*, 114 Wn.2d 842, 849, 792 P.2d 142 (1990).

¹⁵ Wang implies that the bin provision in the Jong Seng contract was related to the bin rental provision in the packing agreement between Fugachee and Lotus. (Resp. Br. at 31; Exs. 20 and 183) But at trial Wang testified that Fugachee was not claiming that Lotus breached the packing agreement. (RP 774-775; Ex. 20) And in its answer to Ta Chi's claim for breach of contract, Jong Seng never asserted that an alleged breach of the packing agreement between Lotus and Fugachee somehow excused Jong Seng's fulfillment of its promises under the contract with Ta Chi. (CP 446-447; 654-655) But after trial Fugachee claimed that it transferred bins to Ta Chi "as consideration for the performance of a packing agreement with Lotus," that Lotus breached the packing agreement, and that therefore the bins had to be returned to Fugachee. (CP 1297) This claim was denied without discussion by the trial court and Fugachee did not appeal that issue. If Exhibit 20 had any relevance to Ta Chi's contract claim, it was that it undermined Wang's testimony that the bins were not intended to be transferred to Ta Chi. The reason a free bin rental would have had value to Fugachee in April 2007 is because it had just transferred its bins to Ta Chi in March. Also, the argument that the bin provisions in two different contracts were consideration for one another does not make sense because the same free rental provision was in the packing agreement between Lotus and a third party grower, it was not unique to Fugachee. (Ex. 21)

I. Wang Misappropriated Revenue that Lotus Earned

In 2006 Summer Fruit made money from handling apples. (RP 588-592) In May 2007 Summer Fruit sold its assets to Lotus (Ex. 170) and between August and October 28, 2007, Lotus handled apples. (RP 400-402, 771-773, 1401-1407; Exs. 15, 16, and 345-4) At the end of October, Wang left Lotus and restarted Summer Fruit, which began handling apples again. (RP 400-402, 773-774)

Exhibit 345, which was prepared by Lotus's forensic accountant, after reviewing Lotus's and Summer Fruit's QuickBooks records, invoices and bills of lading, shows which apple shipments were handled by Lotus and which were handled by Summer Fruit. (Ex. 345; RP 1310-11) The cutoff was October 28, 2007. Shipments before that date left the Lotus facility. Shipments after had non-Lotus bills of lading, indicating they were shipped from somewhere else. (RP 1403-1407, 1599; 1638-1643)

Wang did not dispute the contents of Exhibit 345. In fact, Exhibit 15, offered by Wang, provided a specific example of one of the entries in Exhibit 345. Exhibit 15 is a bill of lading generated on October 15, 2007, two weeks before Wang left Lotus. This same bill of lading appears on Exhibit 345 showing the same date and the same 98 boxes of Fuji apples.

The shipment in Exhibit 15 was handled by Lotus because Summer Fruit was not operating at the time. (RP 398; 400-402; 771-772; 1399-

1402; Ex. 170) Lotus's expert testified that Lotus was paying handling expenses (RP 1402), and the lawyer Wang hired to send a demand letter to the apple line manufacturer on Lotus's behalf stated that as of early October 2007 Lotus was paying \$16,000 a day to have apples packed at another location. (Ex. 341) Wang admitted that Lotus was handling apples up until the time she left the corporation. (RP 773-774)

Lotus's claim against Wang was that Summer Fruit diverted the handling revenue that Lotus had earned before Wang's departure. Exhibit 345 shows that for hundreds of these shipments, instead of Lotus invoicing the buyer, Summer Fruit did. (Ex. 345; RP 773-774) Thus, Summer Fruit collected the revenue, took a handling fee off the top, and passed along the remainder to the grower. Wang did not dispute this, and once again, one of Wang's exhibits showed the diversion.

Exhibit 16 is the invoice for the shipment contained in Exhibit 15. It bears the same tracking number and references the same 98 boxes of Fuji apples. But it is a Summer Fruit invoice not a Lotus invoice. So, the revenue went to Summer Fruit not Lotus. Exhibit 345 showed hundreds of transactions just like the one shown by Exhibits 15 and 16.

Because Summer Fruit collected the revenue without bearing any of the handling costs, its business was hugely profitable in 2007. One indicator is Summer Fruit's financial statements for the two years it

handled apples. In 2006 Summer Fruit made \$984,480 in gross profit on \$2,519,135 in total sales. (Ex. 275) In 2007 it made \$900,158 in gross profit on only \$1,490,240 in total sales.¹⁶ (Ex. 276)

Lotus's expert testified that based on its past gross profit percentages, Summer Fruit made, and Lotus lost, over \$400,000 in profit in 2007 from the diverted handling revenue. (Ex. 345; RP 1408-1419) Wang and Summer Fruit provided no evidence to rebut this calculation.

Wang simply ignores Exhibits 15, 16, and 345, and the testimony of Lotus's forensic expert. Her entire defense to Lotus's claim consisted of one exhibit, a memorandum dated January 11, 2008, from Lotus to Wang requesting payment of industrial charges. (Ex. 43) But that memorandum and Wang's brief testimony about it (RP 1715) in no way rebut the evidence of diversion. Exhibit 43 simply confirmed what Lotus had already stipulated to, that after October 28, 2007, Summer Fruit began handling fruit again. That is why Lotus was demanding that Summer Fruit begin paying certain industry charges that had been billed to Lotus. Wang was asked by her counsel whether Exhibit 43 "indicated whether Lotus Fruit was actually handling any crop during this time frame" (i.e. January 2008) and Wang responded that "they [meaning Lotus] weren't going to handle anymore." (RP 1715) Wang admitted several times during trial

¹⁶ In 2006 Summer Fruit packed cherries. In 2007 it did not.

that Lotus was handling apples up until the date she left. (RP 400-402, 773)

Lotus admits that it was not handling apples in January 2008. But that was not the time period for which it was seeking recovery. Exhibit 43 is consistent with the fact that Lotus handled apples prior to October 28 and Summer Fruit handled them after. It provided no basis for concluding that revenue was not diverted on pre-October 28 shipments. The trial court's implied findings that Wang did not breach her fiduciary duty and that Lotus was not injured were not supported by substantial evidence, particularly when Wang had the burden of proving the propriety of what she had done since it occurred in part during her agency.

J. Wang Profited from Packing and Handling Ta Chi's Fruit

Ta Chi established that Wang was its agent and fiduciary for purposes of marketing its fruit. (CP 1788 ¶ 132; CP 1789 ¶ 135; CP 1795 ¶ 185; CP 1797 ¶ 201) It established that Wang owned Summer Fruit and that she concealed that ownership from Ta Chi. (CP 1770 ¶ 17; CP 1784 ¶¶ 103, 105; CP 1793 ¶¶ 166-167) Wang admitted that she caused Ta Chi to transact business with Summer Fruit while she was Ta Chi's agent. (RP 296, 596-600; Ex. 195) It was not disputed that in those transactions, Ta Chi paid Summer Fruit a total of \$244,958. (Ex. 160(C))

By packing and handling Ta Chi's fruit, Wang was selling Summer Fruit's services to Ta Chi without disclosing her personal interest in the transaction. That was a breach of loyalty. Wang's response at trial was that the sales price was fair. (RP 297-298) The trial court erroneously concluded that because Ta Chi needed to have its fruit packed somewhere and because Summer Fruit's were not proven to be unfair,¹⁷ Ta Chi was not injured. (CP 1794 ¶ 179; CP 1808-09) That was error.

1. The transactions caused a loss to Ta Chi in 2005

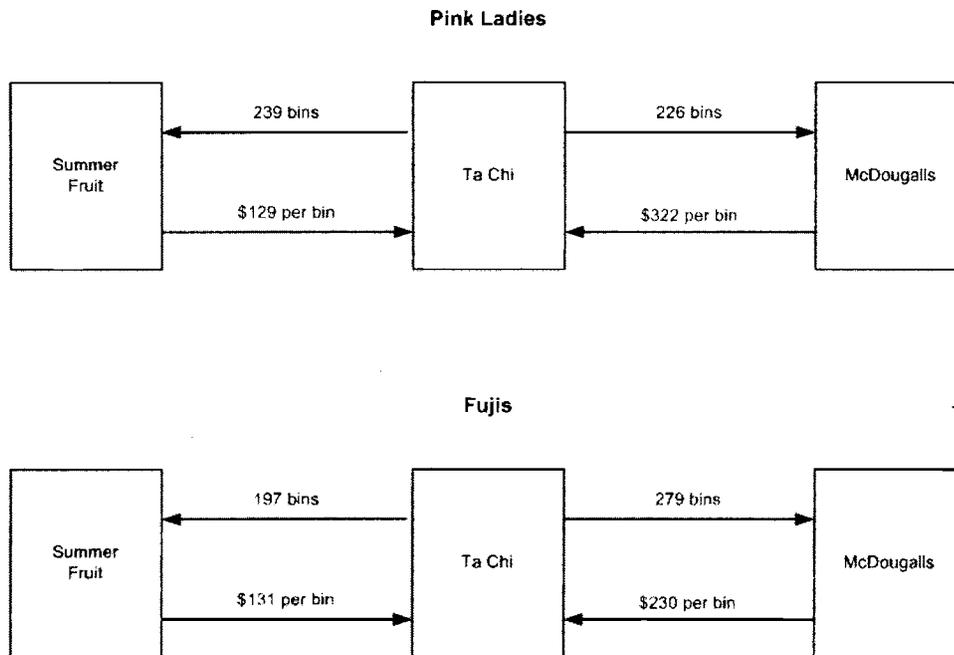
Wang revised the grower settlements for Ta Chi's cherry crop downward by over \$20,000 in 2005. (Exs. 198, 199, 201) Wang could not explain why. (RP 572-575) The mark down was self dealing because it put money in Summer Fruit's pocket at the expense of Ta Chi. Wang had the burden of explaining the transaction. She failed to carry it.

2. The transactions caused a loss to Ta Chi in 2006

Substantial evidence did not support the trial court's implied finding that Ta Chi was not damaged by Summer Fruit's handling of its apples in 2006. It was undisputed that in 2006 Summer Fruit handled roughly half of Ta Chi's Pink Lady and Fuji apple crop, while the other half was packed and shipped by McDougalls & Sons. (Ex. 160(H), 195, 197, 309; RP 596-601) Ta Chi's per bin return from the apples packed

¹⁷ The court again misallocated the burden to prove fairness.

and shipped by McDougall's was several times the net return from the apples handled by Summer Fruit.



Had Wang not engaged in the disloyal transactions, Ta Chi would have received \$46,127 more for its Pink Lady apples ($(\$193 \times 239 \text{ bins})$ and \$19,503 for its Fuji apples ($\$99 \times 197 \text{ bins}$). (Exs. 197 and 309 (TC 1555 and 1559); RP 596-601, 1383-1386)

3. Summer Fruit profited from the transactions

The trial court also erred by not requiring the disgorgement of the profit Summer Fruit and Wang made from the transactions. Where an agent is liable to account for wrongfully received profits, the principal has the burden of proving the revenue that the agent received from the

wrongful transaction, but the agent has the burden of proving the costs associated with the transaction that should be deducted to arrive at the agent's profit. *Wilkins v. Lasater*, 46 Wn. App. 766, 777-78, 773 P.2d 221 (1987); *Gomez v. Bicknell*, 302 A.D.2d 107, 114-15, 756 N.Y.S.2d 209 (2002); *C&B Sales & Serv., Inc. v. McDonald*, 177 F.3d 384 (5th Cir. 1999); RESTATEMENT (SECOND) AGENCY § 403 *cmt c* (1958); *Stella v. Graham-Paige Motors Corp.*, 232 F.2d 299 (2nd Cir. 1956).

This allocation of burdens is similar to that in cases involving the infringement of intellectual property. The intellectual property owner must prove the gross amount of infringer's sales, but the infringer must prove the portions of the sales not attributed to the infringement and any amounts that should be deducted to arrive at gross profit. *See, e.g.*, *Hamilton-Brown Shoe Co., v. Wolf Bros. & Co.*, 240 U.S. 251, 36 S. Ct. 269, 60 L. Ed. 629 (1916); *WMS Gaming Inc., v. WPC Prods. Ltd.*, 542 F.3d 601, 608-09 (7th Cir. 2008); *Petters v. Williamson & Assocs., Inc.*, 151 Wn. App. 154, 165, 210 P.3d 1048 (2009); RESTATEMENT (THIRD) UNFAIR COMPETITION § 45 *cmt f* (1995).

The trial court asked the wrong question. Wang testified that Summer Fruit's charges were fair.¹⁸ But the right question was whether

¹⁸ Wang's self serving testimony alone was insufficient to prove that she did not profit from an interested transaction. *Wilkins v. Lasater*, 46 Wn. App. at 777-78 (citing *Hetrick v. Smith*, 67 Wash. 664, 667-68, 122 P.2d 363 (1912)).

Summer Fruit profited from the transaction. *Becker v. Capwell*, 270 Or. 200, 527 P.2d 120 (1974). The only evidence presented at trial was that Summer Fruit did make a profit. (RP 585, 680; Ex. 180) And Summer Fruit's records showed that it made hundreds of thousands of dollars in profit. (Ex. 275) Wang offered no evidence on the costs that Summer Fruit incurred in packing and handling fruit.

The trial court made no specific finding about how much profit Summer Fruit made from the transactions with Ta Chi. To the extent that is a finding that no profit was made, it was unsupported by the record.

Wang argues that Summer Fruit "earned" the payments it received, but that is not the legal standard by which damages in a breach of fiduciary duty case are measured. Ta Chi admits that Summer Fruit provided it a service. But the evidence was that Summer Fruit profited from those transactions. Ta Chi was entitled to recover that profit. The revenue that Summer Fruit received from Ta Chi was not disputed. It was Wang's burden to show what should have been deducted to arrive at profit. She and Summer Fruit did not do that.

K. There was a Factual Basis for Requiring Disgorgement of Fees

Ta Chi appealed the trial court's decision on whether to disgorge Wang's management fee because it was based on a mistaken legal conclusion that no facts supported disgorgement. Ta Chi does not attack

the trial court's findings that Wang provided some benefit to Ta Chi or that her monthly management fee was reasonable for a loyal manager. Almost all of Wang's response appears to be directed at those two points.

What Ta Chi does appeal is the trial court's mistaken conclusion that there was no factual basis to require disgorgement of her management fee. The trial court found that Wang breached her duty of loyalty in 2002, 2003, 2004, 2005, 2006 and 2007 and that she managed Ta Chi in such a way that she always put her interests first. (CP 1795 ¶ 183) That is exactly what a fiduciary should not do. She covered up an entire lawsuit and engaged in self-interested transactions every single year. She never fully disclosed the facts about the transactions and some the court found to be fundamentally unfair. These facts supported disgorgement. *Kane v. Klos*, 50 Wn.2d 778, 789, 314 P.2d 672 (1957). The trial court wrongly concluded that they did not.¹⁹

L. Ta Chi and Lotus Were Entitled to Attorneys' Fees

Wang asserts that Ta Chi did not plead constructive fraud. Breach of fiduciary duty of loyalty is constructive fraud. *Green v. McAllister*, 103 Wn. App. 452, 467-68, 14 P.3d 795 (2000). Ta Chi alleged that Wang breached her duty of loyalty in multiple ways, and it specifically sought

¹⁹ Wang also argues that there was substantial evidence that Ta Chi knew Wang was paying her fee to Fugachee. Wang testified that she did not tell Ta Chi that because "nobody asked." (CP 1426-27)

attorneys' fees. (CP 733, 739) The pleadings are not a bar to recovery. Wang's second argument is that *Hsu Ying Li v. Tang* was a common fund case. That is incorrect. The *Tang* court held the common fund exception did not apply. 87 Wn.2d 796, 799, 557 P.2d 342 (1976) ("This suit merely benefited petitioner . . . petitioner is not entitled to relief under the common fund exception"). Wang ignores *Green v. McAllister*, which held that in breach of loyalty cases the trial court should use its discretion to decide whether fees should be awarded and explain the basis for the award or denial. 103 Wn. App. at 468-69; *Simpson v. Thorsland*, 151 Wn. App. 276, 288, 211 P.3d 469 (2009). There was a substantive basis for awarding Ta Chi and Lotus their fees on their breach of fiduciary duty claims. Respondents apparently do not dispute Ta Chi's claim that it should have received its attorneys' fees on its breach of contract claim against Jong Seng.

III. RESPONSE

A. Wang Misstates the Law in Her First Assignment of Error

Wang cites ¶¶ 103, 114, 118, 119, 122, 210-214 (CP 1784-87, CP 1798-99) of the trial court's findings and conclusions as being in error but does not specifically address the evidence related to each finding in her brief. (Response at 42) Instead, most of her argument recites legal

principles applicable to fiduciaries. But her argument misstates the governing law.

1. An agent is a fiduciary of her principal

Wang begins with a selective quote from *Micro Enhancement Int'l, Inc. v. Coopers & Lybrand, LLP*, 110 Wn. App. 412, 40 P.3d 1206 (2002). The court there listed a number of relationships that are fiduciary in nature as a matter of law. Wang cited the attorney-client relationship as one example. The full list from the *Micro Enhancement* case included the relationship of principal and agent. *Id.* Also, Wang ignores that *Micro Enhancement* also cited approvingly *Liebergessell v. Evans*, 93 Wn.2d 881, 889-90, 613 P.2d 1170 (1980), where the Washington Supreme Court held that a borrower could be the fiduciary of a lender in connection with a loan transaction.

2. Employees and managers can be fiduciaries

Wang next argues, citing *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*,²⁰ that corporate managers and employees are not automatically fiduciaries. *Goodyear* is nothing like this case. It involved a written contract between a tire manufacturer and tire dealer. The contract expressly allowed the manufacturer to sell in the dealer's area, which it did. *Id.* When the dealer went out of business, it still owed

²⁰ 86 Wn. App. 732, 935 P.2d 628 (1997), *review denied*, 133 Wn.2d 1033 (1998).

money to the manufacturer, who sued. As a counterclaim, the dealer argued that the manufacturer owed it a fiduciary duty not to hurt its business by selling tires in its area. Based on the express contract language saying the opposite, the *Goodyear* court dismissed all of the claims, including the breach of fiduciary duty claim. No fiduciary duty existed. The manufacturer was plainly not agreeing to place the dealer's interests above its own contractual rights.

Wang also mischaracterizes *Gilliland v. Mount Vernon Hotel Co.*²¹ *Gilliland* involved a dispute between a landlord and tenant. The landlord leased its hotel to the tenant. The tenant defaulted on the lease. The landlord took possession of the hotel but the tenant agreed to temporarily manage the hotel for the landlord. Meanwhile, both asserted legal claims against one another based on the lease. Both hired counsel to negotiate a settlement. During those negotiations, and without the landlord's knowledge, the tenant acquired a promissory note from one of the landlord's creditors. After the settlement agreement was executed, the tenant sued on the promissory note. *Id.* The landlord claimed that concealing the fact that the tenant held the note fraudulently induced it to sign the settlement. The Supreme Court held that the tenant was not the landlord's fiduciary for purposes of the settlement negotiation given that

²¹ 51 Wn.2d 712, 321 P.2d 558 (1958).

they were essentially involved in a pre-litigation dispute. And, although the tenant temporarily managed the hotel, it had no involvement in the landlord's financial operations and specifically declined the landlord's request to negotiate with the third-party note holder. The facts in *Gilliland* look nothing like the facts here.

Wang suggests that managers are not fiduciaries. But managers and employees can be, and often are, agents and fiduciaries. *Crisman v. Crisman*, 85 Wn. App. 15, 22, 931 P.2d 163, *review denied*, 132 Wn.2d 1008 (1997) (manager of jewelry store was the store owner's agent and fiduciary); RESTATEMENT (THIRD) AGENCY § 1.01 *cmt c* (2006) ("The elements of common-law agency are present in the relationships between employer and employee"). The scope of their agencies and fiduciary duties will of course depend on the nature of their jobs.

3. An agency relationship can exist between counterparties

The crux of Wang's argument is based on the incorrect assumption that once a principal knows that an agent has an adverse interest in a transaction, the agency relationship, and its accompanying fiduciary duties, disappear. (Response at 44-46) None of the cases cited by Wang actually says that. Indeed, the position is fundamentally inconsistent with established precedent. A fiduciary relationship can exist between counterparties. *Liebergessell v. Evans*, 93 Wn.2d 881, 889-90, 613 P.2d

1170 (1980) (borrower and lender); *Voellmeck v. Harding*, 166 Wash. 93, 103, 6 P.2d 373 (1931); RESTATEMENT (FIRST) CONTRACTS § 472(1)(c)(1932); RESTATEMENT (SECOND) AGENCY §§ 389-92 (1958). Even if the trial court had found that Wang had disclosed her interest in Summer Fruit, that fact would not have precluded Wang from being Lotus's agent and fiduciary in the transaction.

Similarly, Wang cites her management of Summer Fruit as another fact that precluded her agency for Lotus. Again, that fact did not preclude her agency for Lotus. RESTATEMENT (SECOND) AGENCY §§ 389-92; *Liebergessell*, 93 Wn.2d at 889-90. Further, the fact that she ran the cherry line did not mean that she would profit from its sale. Sale or no sale, Wang would still operate the line, either for Lotus or for Summer Fruit. And in May 2007, Lotus and Ta Chi believed that Wang was going to be a very large shareholder of Ta Chi, Lotus's parent company. (RP 904-906; Ex. 118) In other words, Lotus thought that Wang, as shareholder of Lotus's parent, was going to have an interest in the cherry line *after* the transaction.²²

²² Wang throws in a straw man argument that friendship alone does not create an agency relationship. (Response at 44) There was no indication that the trial court's finding that Wang was Lotus's agent was based on any personal friendship she had with Mr. or Mrs. Shen. Wang was chosen to manage Ta Chi because she was an expert. (CP 1775)

B. Wang was Lotus's Agent for the Summer Fruit Transaction

The trial court found that Wang was Lotus's agent in the transaction with Summer Fruit and that she breached her fiduciary duty to Lotus because she concealed her ownership of Summer Fruit, she concealed what Summer Fruit paid for the assets sold, and the transaction was unfair to Lotus. (CP 1786 ¶ 118; CP 1793 ¶¶ 166-169; CP 1798 at ¶ 210) Wang asserts that the initial finding of an agency relationship was error. The existence of a principal-agent relationship is a fact question. *O'Brien v. Hafer*, 122 Wn. App. 279, 284, 93 P.3d 930 (2004). In this case, there was substantial evidence that Wang was Lotus's agent.

Wang was Ta Chi's fiduciary. In that capacity she proposed that Ta Chi enter the packing business, and she identified the cherry line as a potential acquisition. (CP 1782 ¶ 94; Exs. 112, 113, and 180) Once Lotus was formed in September 2006, Wang served as its general manager until October 2007. (CP 1784 ¶ 102) Lotus paid her a management fee. (Ex. 160(CC)) Wang controlled Lotus's bank account and accounting records, and she oversaw the acquisition of its assets. (CP 1784 ¶ 102; Exs. 180, 163, 347) She communicated with its vendors, and when it got in a dispute with the apple line manufacturer, she hired an attorney to write a demand letter for Lotus. (CP 1784 ¶ 102; Exs. 125, 341)

Wang purported to deal with Summer Fruit on Lotus's behalf. (CP 1785-86 ¶ 112-113) She stipulated before trial that she negotiated the purchase of the cherry line for Lotus. (CP 669 ¶ 31) The trial court found that Wang negotiated with Summer Fruit on Lotus's behalf, or at least pretended to negotiate. (CP 1785-86 ¶ 112-113) Wang also helped Lotus obtain a bank loan to finance the purchase.²³ (CP 1784 ¶ 102; Ex. 157) After the Summer Fruit transaction was signed, Wang again pretended to deal with Summer Fruit on Lotus's behalf. (CP 1785 ¶ 109; Exs. 125-126) Lotus's documents also showed a lack of knowledge. (CP 1784 ¶ 104-106)

Mrs. Shen, who signed the Summer Fruit agreement for Lotus, testified that Wang told her that the cherry line was owned by a friend of Wang's father. (RP 884-885; 906-07) She specifically thought Wang was acting in Lotus's best interest. (RP 913) Mrs. Shen also testified that in March 2007 Wang had agreed to become a part owner in Ta Chi, Lotus's parent company. (RP 904-906)

Wang testified that she acted in Ta Chi's best interest at all times. (RP 436-437) She also testified that she never told Lotus that she was Summer Fruit's agent. (CP 868) There was no written evidence in the

²³ RESTATEMENT (THIRD) AGENCY § 1.01 *comment c* (2006) (agents often have authority to negotiate or transmit information on behalf of their principal).

record that Wang disavowed any of the powers or authorities entrusted to her by Lotus prior to the Summer Fruit transaction.

C. Wang Concealed Her Ownership of Summer Fruit

The trial court found that Wang intentionally concealed her ownership of Summer Fruit. (CP 1784 ¶ 103; CP 1793 ¶ 166-168) A raft of evidence supported that finding.

Numerous documents showed Wang's concealment. Her April 2006 letter said the cherry line was owned by third parties. (Ex. 112) The Lotus business plan Wang drafted did not disclose her interest. (Ex. 180) Wang had a friend sign the agreement for Summer Fruit, even though he was not an owner, director, officer, or employee of Summer Fruit.²⁴ (CP 754; Ex. 170) In May 2007, the same month the contract was signed, Wang sent a letter to Lotus purporting to convey a message from Summer Fruit and requesting instruction on how to respond. (Ex. 157) In October 2007, when Lotus still had not paid the purchase price, Wang told Lotus that Summer Fruit had "called again" and that "they hope that you will remit payment" for the cherry line. (Ex. 125) Several days later, in a letter discussing Lotus operations, Wang reminded Mrs. Shen about the demand letter from Summer Fruit's attorney. (Ex. 126) The demand

²⁴ Wang testified that Mrs. Shen, a non-English speaker, told her to conceal her ownership of Summer Fruit from the bank. By finding that Mrs. Shen did not know of Wang's interest, the trial court necessarily disbelieved Wang's testimony.

letter itself, sent by Wang's attorney, did not mention her. (Ex. 350) The court cites still more supporting documents in its findings.

Witness testimony also showed concealment. When first asked about whether she disclosed her ownership of Summer Fruit, Wang testified that she did not recall. (RP 759-761; CP 867) Mr. and Mrs. Shen testified that Wang told them that Summer Fruit was owned by friends of Wang's father. (RP 874, 907) Jack Wu testified that he did not tell Lotus that Wang owned Summer Fruit and he did not know whether Lotus knew that before the transaction. (RP 1682-1687)

D. Wang's Evidence did not Disprove an Agency Relationship

Wang argues that Lotus knew two things that prevented an agency: (1) that she managed Summer Fruit and (2) that she owned Summer Fruit. As noted above, Lotus admits that it had knowledge of the first fact. It did not know the second. As just discussed, there was very damning evidence that Wang repeatedly lied to Lotus about her ownership of Summer Fruit. Wang cites the testimony of Herman Chen to support her position that Lotus did know about her ownership of Summer Fruit and therefore — according to Wang's erroneous legal position — she could not have been Lotus's agent in the transaction. There are a number of problems with her argument.

First, Mr. Chen plainly thought Wang was Lotus's agent. He testified that Wang was part of the Ta Chi "family" and that Wang was always acting in Lotus's best interest. (RP 992, 999, 1013) He was unaware that she would make a profit from the cherry line. (RP 1013)

Second, Wang did not establish that Mr. Chen was Lotus's agent for the Summer Fruit transaction. An agent's knowledge is only imputed to his principal if the knowledge pertains to something within the scope of the agency. *Pennoyer v. Willis*, 26 Or. 1, 8-10, 36 P. 568 (1894). Wang testified that the only Lotus representative with whom she spoke about the Summer Fruit transaction was Mrs. Shen. (CP 886-888) Wang said she never spoke with Mr. Chen about the Summer Fruit transaction. (CP 889) After a falling out between Mr. Chen and the Ta Chi shareholders in February 2007, he had no substantive role in Lotus or Ta Chi.²⁵ (RP 1029; CP 888-889; Ex. 116) By May 2007 he was not playing any active role in the business.

Third, Wang's reliance on constructive knowledge is misplaced. Unlike in transactions with third parties, a disloyal agent may not rely on a disclosure to another agent to satisfy her fiduciary disclosure obligations

²⁵ Mr. Chen retained the title of vice president for a time but had no decision making authority. Later he would exchange his Ta Chi shares for the Shens' shares in his business. (RP 1005-06) Although estranged from the Ta Chi shareholders, he continues to do business with Wang. (Ex. 342)

when there is evidence that she knows the principal lacks actual knowledge. *Sands v. Eagle Oil & Ref. Co.*, 83 Cal. App. 2d 312, 188 P.2d 782, 786 (1948) (“As between two innocent parties, notice to the agent of one is notice to the principal, but, as between the principal and the fraudulent agent, notice of another agent should not be imputed to the principal”)(citation omitted). Mr. Chen admits that Wang never disclosed her interest in writing and that he never specifically told anyone about it. (CP 1787-88 ¶ 129; RP 1011, 1031-32) There was overwhelming evidence that Wang knew Mrs. Shen, the Lotus representative signing the agreement, did not have actual knowledge of Wang’s ownership of the cherry line at the time of the transaction. Washington cases are clear that an agent must ensure her principal has “explicit knowledge” of her interest. *Moon v. Phipps*, 67 Wn.2d. 948, 954, 411 P.2d 157 (1966); *Kane v. Klos*, 50 Wn.2d 778, 785, 314 P.2d 672 (1957); *Mersky v. Multiple Listing Bureau of Olympia, Inc.*, 73 Wn.2d 225, 229, 437 P.2d 897 (1968).

Finally, and as previously discussed, a principal’s knowledge that an agent is an adverse party does not mean the fiduciary relationship is extinguished. *Mersky*, 73 Wn.2d at 232 (observing that agent can transact business with principal and still owe duties of full disclosure); *Liebergessell v. Evans*, 93 Wn.2d 881, 889-90, 613 P.2d 1170 (1980). At the end of the day, even if Wang had convinced the trial court that she had

not repeatedly lied to Lotus, there was still substantial evidence that she was Lotus's agent.

E. The Summer Fruit Transaction was a Breach of Loyalty

Although disputing her agency, Wang does not argue that she fulfilled her fiduciary duty to Lotus, assuming she was its agent. As repeated throughout, an agent breaches her duty of loyalty by transacting business with her principal if (1) she does not fully disclose her interest in the transaction; (2) she does not fully disclose all material facts about the transaction, *or* (3) the transaction is unfair to the principal.²⁶ Wang had the burden of proving that all three conditions had been satisfied. She failed on all three counts. (CP 1784-87 ¶¶ 103, 114-118, 120, 122).

The trial court found that Wang intentionally covered up her ownership of Summer Fruit from Lotus and Ta Chi. (CP 1784 ¶ 103; CP 1786 ¶ 114) Substantial evidence supported that finding. *See* § III(C) *supra*. Wang also concealed other material facts about the transaction. She did not disclose the prices Summer Fruit paid for the assets it was selling to Lotus. (CP 1793 ¶ 169; CP 1418, RP 763) She did not provide Lotus with Summer Fruit's operating results for 2005 and 2006. (CP 1420) She did not disclose that the number of boxes Summer Fruit

²⁶ RESTATEMENT (SECOND) AGENCY § 389 (1958); RESTATEMENT (SECOND) CONTRACTS § 173 (1981); Moon, 67 Wn.2d at 954; State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co., 64 Wn.2d 375, 391 P.2d 979 (1964); Cogan v. Kidder, Mathews & Segner, Inc., 97 Wn.2d 658, 648 P.2d 875 (1982); Mersky, 73 Wn.2d at 229.

actually packed in 2005 and 2006 were only a fraction of the number that she projected Lotus would pack in 2007 and 2008 (RP 741-743; Exs. 179-180) Wang's failure to disclose this information was an independent basis to rescind the transaction. *See, e.g.*, RESTATEMENT (SECOND) AGENCY § 390 *illus.* 2 (1958). Finally, the trial court found that the transaction between Lotus and Summer Fruit was unfair to Lotus because the price charged for the used assets was significantly greater than the price Summer Fruit paid for them new. (CP 1786-1787 ¶ 120) Wang does not dispute this finding, which is yet another independent basis for rescinding the transaction. RESTATEMENT (SECOND) AGENCY § 390 (1958).

F. The Highland Lease and Lawsuit Involved Breaches of Loyalty

Wang concedes that she was Ta Chi's fiduciary, that she concealed the Highland lease, that she ran the Highland expenses and revenues through a secret bank account, and that she made a \$12,312 profit from the Highland opportunity. (CP 1789 ¶¶ 136-147) She further concedes that when the Highland partnership sued Ta Chi, she covered up the lawsuit while having Ta Chi pay over \$200,000 in litigation costs. (CP 1789-90 ¶¶ 142-146) Despite these facts, Wang contends that she should not owe Ta Chi money for the losses it sustained in defending the *Highland* lawsuit. She claims her decision was protected by the business judgment rule and that Ta Chi cannot recover both the profit she made from the

Highland tract and its loss from the *Highland* lawsuit. Neither argument has merit.

1. The business judgment rule does not protect Wang

The business judgment rule is not a shield to a breach of loyalty claim. *Grasmueck v. Barnett*, 281 F. Supp. 2d 1227, 1232 (W.D. Wash. 2003) (“when directors breach the duty of loyalty or act in bad faith they are not shielded by the director protection statutes”)

Wang argues that the Highland orchard could have made Ta Chi money. That may have been true had Wang operated the orchard for Ta Chi's benefit. But the trial court found Wang took the opportunity for herself, saddling Ta Chi with the legal obligations on the lease. (CP 1789-90 ¶¶ 137-147) That was a breach of loyalty. She concealed the bank account from Ta Chi's officers and directors, another breach. She then concealed the *Highland* lawsuit from Ta Chi, a breach of care and loyalty.

Significantly, by concealing the lawsuit, Wang continued the cover-up of the opportunity that she had taken from Ta Chi. Had Ta Chi found out about the Highland lease, Wang would have been fired. Thus, her handling of the lawsuit was an interested transaction, just like the lease itself. Wang's cover up prevented Ta Chi from asserting (1) that the lease was an unauthorized act and (2) that Wang should have been added as a defendant. Had Wang's disloyal conduct been revealed, it may have led to

a quick end to the lawsuit for Ta Chi or resulted in Wang's liability instead of Ta Chi's. In concealing the lawsuit Wang prevented Ta Chi from mitigating the loss from her earlier breach.

While the concealment clearly benefitted Wang, there is no conceivable way it benefitted Ta Chi. What corporate board in the world would not want to know about a bet-the-company lawsuit?

At bottom, the loss Ta Chi sustained was a direct result of Wang's breaches, including her signing Ta Chi's name to the lease, her concealment of the lawsuit, and her theft of a corporate opportunity. The business judgment rule does not protect these wrongful acts. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993); *Grassmueck*, 281 F. Supp. 2d 1227.

2. Ta Chi can recover both Wang's profit and its loss

Wang also argues that if Ta Chi recovers the profit she realized from the Highland lease then it must also accept the loss occasioned by the *Highland* lawsuit. This argument gets the law exactly backwards.

When an agent breaches her fiduciary duty of loyalty, her principal can recover both the agent's profit and the principal's loss caused by the breach. RESTATEMENT (SECOND) AGENCY §§ 388, 401, 403, and 407(1) (1958); RESTATEMENT (THIRD) AGENCY § 8.03 (2006) ("An agent's breach of duty also subjects the agent to liability for loss caused the

principal and to liability for benefits acquired by the agent”); *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co.*, 64 Wn.2d 375, 385-86, 391 P.2d 979 (1964); *Guth v. Loft*, 5 A.2d 503, 510 (Del. Ch. 1939); RESTATEMENT (SECOND) AGENCY § 401 *cmt. d* (1958) (“agent who subjects his principal to liability because of a . . . wrongful act is subject to liability to the principal for the loss”). The trial court’s judgment regarding the Highland lease and lawsuit was correct.

G. The Trial Court did not Err in Denying Wang’s Fees

The trial court’s denial of Wang’s request for fees is reviewed for an abuse of discretion. *Mahler v. Szucs*, 135 Wn.2d 398, 434-35, 957 P.2d 632 (1998).

The Ta Chi Bylaws allow for indemnification of an officer, agent or employee sued by the corporation if she: (1) acted in good faith, (2) did not derive a personal benefit from the challenged conduct, (3) did not act negligently, and (4) did not engage in willful misconduct. (Ex. 235) As the party seeking indemnification, Wang bore the burden of proof on these points. The trial court did not make specific factual findings on these issues, so it is assumed that it found against Wang. *Ellerman v. Centerpoint Prepress, Inc.*, 143 Wn.2d 514, 524, 22 P.3d 795 (2001).

Detailed analysis of whether there was evidence supporting these adverse findings is difficult given that Wang does not identify the specific

claims for which she seeks indemnification. Because her claim is only based on the bylaws, she cannot be seeking indemnification for claims by or against her entities, claims by or against Lotus or claims by her against Ta Chi. As to the remaining claims, those by Ta Chi against Wang, Wang asserts without support that she acted in good faith and did not derive a benefit. She cites no facts or legal authority supporting these bald assertions.

Wang had the burden of proving good faith. She did not prove it. Every claim that Ta Chi brought against Wang involved her admitted self-dealing. In all instances she was representing Ta Chi while standing on the other side of the transaction. As a matter of law, that constitutes bad faith.²⁷ The trial court found that Wang “always had her own interests in mind and took care of those interests first.” (CP 1795 at ¶ 183) She also did not prove that she derived no benefit from the transactions. Indeed, she admitted that she did. (RP 585, 680; Exs. 180, 275). In short, Wang failed to carry her burden of showing she was entitled to indemnification.

Moreover, even if she had, Ta Chi was statutorily prohibited from indemnifying Wang. Washington law prohibits a corporation from

²⁷ *Stone ex rel AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 369-70 (Del. 2006) (good faith is a subsidiary element of the duty of loyalty); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993); *Grassmueck v. Barnett*, 281 F. Supp. 2d 1227 (W.D. Wash. 2003).

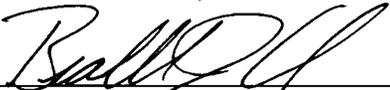
indemnifying an agent in any proceeding in which the agent was liable to the corporation. RCW 23B.08.500(7), .510 and .570. Ta Chi and Lotus obtained roughly \$500,000 in judgments against Wang and her entities for breaches of her fiduciary duties. She cannot be indemnified.

IV. CONCLUSION

Ta Chi and Lotus respectfully request that this Court affirm the trial court's judgments regarding the rescission of the Summer Fruit transaction, the Highland lease and lawsuit, and the denial of Wang's fees. They also request that the Court grant the relief requested in their opening brief.

DATED this 1st day of February, 2011.

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CERTIFICATE OF SERVICE

I hereby certify under penalty of perjury under the laws of the State of Washington that on the 1st day of February, 2011, I caused a true and correct copy of the foregoing document, "Appellants' Reply Brief," to be mailed via Federal Express, overnight delivery, to the following counsel of record:

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