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COURT OF APPEALS
DIVISION III
STATE OF WASHINGTON
By _____

No. 304574

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

Lanzce G. Douglass Investments, LLC, and Douglass Parcel 6B, LLC,

Appellants,

v.

Secure Self Storage, LLC,

Respondent.

APPELLANTS' REPLY BRIEF

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A. SUMMARY OF ARGUMENT

Harley Douglass' response brief makes three fatal errors.

First, Harley Douglass claims incorrectly that the operating agreement of Douglass Parcel 6B, LLC contains reasonable and equitable alternatives to judicial dissolution. The Article VI provisions cited by Harley Douglass provide no enforceable mechanism to allow payment for the departing member's interest and, therefore, fail the "reasonable" and "equitable" minimum standard.

Second, Harley Douglass claims incorrectly that the 30-year duration stated in the operating agreement provides conclusive evidence that the brothers intended to complete the development over a three decade period. The 30-year duration, as briefed below, is an artifact of Washington's limited liability company statute, the 30-year default provisions of the original RCW 25.15.270, and the provisions of federal tax regulations regarding alternatives to "perpetual" existence. Furthermore, under the Washington subdivision statute, RCW 58.17.140, the remaining life of the subdivision approval compresses to seven years after the preliminary plat is approved. Five of those seven years have already been lost to deadlock and impasse that has existed since 2008.

Finally, Harley Douglass claims incorrectly that the trial court could properly ignore the substantial, unrefuted evidence presented by

Lanzce Douglass in support of impasse and the costs of delay. Harley Douglass argues, in effect, that two 20-year veteran developers of multiple residential sub-divisions in Spokane County are incompetent to testify on first-hand knowledge of the costs they incurred, the costs remaining, the schedule required, and their confidence (or lack of confidence) in the market based on their knowledge of sales in the immediate vicinity of the planned subdivision. Both are competent to testify. Harley Douglass did not refute the simple, material facts placed in evidence by Lanzce Douglass.

Each of these errors are discussed separately below.

B. ARGUMENT

- 1. Douglass Parcel 6B, LLC's operating agreement makes judicial dissolution the only reasonable and equitable remedy. The alternative remedies in Article VI "Dissociated Members" provides no binding provision for a departing member to receive the value of that member's interest.**

Harley Douglass properly relies on the facts and rationale of *Haley v. Talcott*, 864 A.2d 86 (Delaware Court of Chancery, 2004). but he misapplies the holding to the facts of this case.

The parties agree that an alternative exit provision in a limited liability company agreement is no substitute for judicial dissolution unless the departing partner has a mechanism to receive the fair market value of his interest. Harley Douglass' adoption of this principle is stated as

follows:

If a limited liability agreement itself provides a fair opportunity for a dissenting member who disfavors the inertial status quo to exit and receive the fair market value of his interest in the company, it is at least arguable that the limited liability company may still proceed to operate practicably under its agreement because the agreement itself provides an equitable way to break the impasse. *Haley v. Talcott*, 864 A.2d 86, 96 (2004).

Brief of Respondent, p. 24.

Harley Douglass argues that the dissociation provisions of Article 6 of the operating agreement provide the required reasonable and equitable alternative to judicial dissolution because they contain an enforceable buyout provision. This argument is simply, demonstrably false. Counter to the *Haley v. Talcott* standard, the buyout mechanism for Douglass Parcel 6B is not enforceable by the departing member and provides no mechanism to guarantee any payment at any time.

The plain language of Article 6 places compensation to a departing member solely and exclusively in the hands of member who remains. The underlined language of Section 6.02, below, was omitted from Harley Douglass' analysis. It makes clear that the departing member has no expectancy or enforceable right to receive any payment for his interest at any time during the life of the enterprise:

6.02. Compensation of Disassociated Members.

(1) Upon the dissolution/termination of an LLC Member withdrawal, resignation, retirement, bankruptcy or insolvency of a Member; the unaffected Members shall have the right, but not the obligation, to buyout the interest of the affected Member as provided herein. The unaffected Members shall also have the right but not the obligation to elect to sell the LLC and/or all its assets. In such event the parties agree to cooperate in order to obtain the highest possible price and the best possible terms for a sale of the LLC *and/or* all its assets. The unaffected Members shall have 90 days from the occurrence of the triggering event to give written notice of their election to the affected Member or its legal representative as the case may be. In the event the unaffected Members elect neither of the foregoing options, the affected Member shall be free to sell its interest to a third party.

(2) In the event the unaffected Members elect to purchase the interest of the affected Member upon the occurrence of a triggering event; the Member, or the estate or legal representative thereof, shall be entitled to compensation in an amount equal to the fair market value of the Member's interest in the LLC as of the date of the triggering event. The fair market value of the Member's interest shall be determined by agreement of the parties or by appraisal as provided herein. The amount payable under this section shall be paid by the Company to the deceased or disassociated Member, or to the estate or legal representative thereof, in installments with interest as provided herein.

(3) In the event the unaffected Members elect to purchase the interest of the affected Member upon the occurrence of a triggering event; the parties shall first endeavor to agree upon the fair market value of the affected Member's interest in the LLC. Failing such agreement the parties shall attempt to agree upon a single neutral appraiser to determine the fair market value of the affected Member's interest in the LLC. Failing agreement upon a single neutral appraiser, the affected Member shall select a single neutral appraiser; the unaffected Members shall select a single neutral appraiser; and, the two appraisers so selected shall select a third neutral appraiser. The appraisers so selected shall attempt to agree upon a value for the affected Member's interest in the LLC. Failing

such agreement, the opinion which is neither highest nor lowest shall be the value of the of the affected Member's interest. The opinion of the appraisers shall be final and binding upon the parties to the full extent allowed by Washington law. The parties shall split the cost of a single appraiser. If three appraisers are utilized, each party shall pay their appraiser and split the cost of the third appraiser.

(4) In the event of a buyout, the terms of the buyout shall be cash.

Operating Agreement of Douglass Parcel 6B, LLC. CP 33, 40-41
(emphasis added).

As in *Haley v. Talcott*, this court should reject the false argument by Harley Douglass that the operating agreement provides a "reasonable" and "equitable" alternative to judicial dissolution. As in *Haley v. Talcott*, the alternative provision to judicial dissolution has similar fatal flaws. The buyout mechanism fails to separate the deadlocked members and strips the departing member of any say in the company while leaving his investment at risk. In *Haley v. Talcott* the departing member received his equity but potentially remained liable for debt. In the present case, the departing member would not even receive his equity. His investment would remain tied up indefinitely and placed at risk without any input into the direction, or the completion, of the enterprise. Article 6 compounds the problems of the deadlock and impasse.

The courts that have addressed this issue have addressed the standard that must be applied to make an alternative provision a

meaningful substitute for judicial dissolution of a deadlocked company. In commenting and applying *Haley v. Talcott*, the Delaware courts have underscored this point.

If deadlock “cannot be remedied through a legal mechanism set forth within the four corners of the operating agreement, dissolution becomes the only remedy available as a matter of law.” *Fisk Ventures*, 2009 WL 73957, at *7. A contractual solution precludes judicial dissolution only if it is “reasonable” and thus an “equitable alternative.” See *Haley v. Talcott*, 864 A.2d 86, 88, 96–98 (Del. Ch.2004)

Leaving the parties to their contractual dispute resolution mechanism would be ineffective and inequitable. . . . Deferring to the contractual mechanism would return the parties to square one and the intolerable *status quo ante* that prompted Phillips originally to file this litigation.

Phillips v. Hove, 2011 WL 4599707 at * 18 (Del Ch. Sept. 22, 2011)¹

Article 6 of the Douglass Parcel 6B, LLC's operating agreement is not an effective contractual dispute resolution provision and, because the buyout provisions are not enforceable by the departing member, Article 6 is ineffective and inequitable. Article 6 would compound the impasse, increase the risk, and provide no reasonable or equitable relief as an alternative to judicial dissolution.

¹ Pursuant to GR 14.1 a copy of this decision was attached to *Appellants' Opening Brief* together with authority of the Delaware Courts allowing citation of unpublished decisions.

Article 6 was never intended to fulfill the role of an alternative for judicial dissolution in cases of deadlock in the direction and operation of the company.

2. **The stated 30-year duration of Douglass Parcel 6B, LLC in the operating agreement is an artifact of the original Washington Limited Liability Company Act and a creature of federal tax provisions. It provides no evidence of the expected timeframe for the company to complete the development.**

Harley Douglass would like this Court to believe that the standard 30-year term stated in the operating agreement for Douglass Parcel 6B, LLC provides compelling and determinative evidence that Harley Douglass and Lanzce Douglass intended the company to take up to three decades to develop this one subdivision.

The 30-year duration is nothing more than an artifact of federal tax law and Washington's original limited liability company act statute, adopted in 1994, which contained the following provision:

Sec. 801. DISSOLUTION. A limited liability company is dissolved and its affairs shall be wound up upon the first to occur of the following:

- (1) The date specified in a limited liability company agreement, or thirty years from the date of the formation of the limited liability company if no such date is set forth in the limited liability company agreement;

Laws of 1994, ch.211, § 801, codified at RCW 25.15.270 (emphasis added).

The reason for this provision, and the reason it survives in many form limited liability company agreements, has nothing to do with the expected duration and everything to do with the negative consequences of selecting "perpetual" duration instead. The default 30-year provision sought to avoid the risk of having the limited liability company taxed as a corporation, rather than the preferential tax treatment as a partnership or as a disregarded entity.

A scholarly article published at the time described the dilemma, noting that the alternative to 30 years was to state an even longer duration period, so long as the duration was not listed as "perpetual." The rationale is as follows:

[I]f a LLC has centralized management and limited liability, and it does not have free transferability of interests and continuity of life, the IRS will tax the LLC's income only after it has passed through to its individual members. On the other hand, if a LLC has three of the four corporate characteristics, the IRS will treat it as an entity for tax purposes: the LLC's income will be taxed first as income to the LLC, and then the LLC's members will be taxed individually on any distributed profits.

A Washington LLC will always have the characteristic of limited liability. Thus, the LLC members must primarily be concerned with avoiding two of the remaining three characteristics: free transferability of interests, centralization of management, and continuity of life. The Washington LLC statute addresses the continuity of life characteristic by providing a default provision which mandates dissolution of the LLC within thirty years of the filing of its certificate of formation.

Jessica A. Eaves, *A Step in the Right Direction: Washington Passes the Limited Liability Company Act*, 18 Seattle U. L. Rev. 197, 211 (1994).

Harley Douglass does not argue that the 30-year duration was specifically negotiated or that 30 years would be an acceptable amount of time to tie up the substantial costs of acquisition and development with no prospect of return on investment and the certainty that the approved development will expire.

Under the controlling statute for the subdivision of land, the approval of the preliminary plat starts a ticking time bomb that creates significant risk and drives the development forward. If the preliminary plat approval expires there is no guarantee of an extension and no certainty what the conditions of extension will be.

RCW 58.17.140 is titled "Time limitation for approval and disapproval of plats—Extensions" states:

Preliminary plats of any proposed subdivision and dedication shall be approved, disapproved, or returned to the applicant for modification or correction within ninety days from date of filing thereof unless the applicant consents to an extension of such time period or the ninety day limitation is extended to include up to twenty-one days as specified under RCW 58.17.095(3): PROVIDED, That if an environmental impact statement is required as provided in RCW 43.21C.030, the ninety day period shall not include the time spent preparing and circulating the environmental impact statement by the local government

agency. Final plats and short plats shall be approved, disapproved, or returned to the applicant within thirty days from the date of filing thereof, unless the applicant consents to an extension of such time period. A final plat meeting all requirements of this chapter shall be submitted to the legislative body of the city, town, or county for approval within seven years of the date of preliminary plat approval. Nothing contained in this section shall act to prevent any city, town, or county from adopting by ordinance procedures which would allow extensions of time that may or may not contain additional or altered conditions and requirements.

(emphasis added).

This short window to complete development (or bond the costs of infrastructure) creates the practical urgency to resolve the impasse and deadlock. Harley Douglass' refusal to either sell or build, puts all of the costs committed to date at risk. Harley Douglass is using impasse and deadlock to force Lanzce Douglass to either take this unacceptable risk or to exit the company "voluntarily" with absolutely no enforceable mechanism to recover his investment by purchasing, modifying, or otherwise completing the development before it expires. Impasse and deadlock support Harley Douglass' "do nothing" approach, but it does not allow for the completion of the development according to the purpose of the company.

Under Harley Douglass' theory of the case, he can hold Lanzce Douglass hostage to Harley Douglass' reckless and irresponsible behavior.

3. **Lanzce Douglass' case was built on material facts and competent evidence of deadlock, dysfunction, acrimony between partners, frustration of business purpose, costs invested, costs expected, the market for homes in the area, risk caused by deadlock, and waste. These are controlling factors in regard to the legal and equitable grounds for judicial dissolution.**

Harley Douglass claims in effect, without citation to any specific defects, that Lanzce Douglass failed to lay a proper foundation for his testimony in opposition to summary judgment. Despite both the opportunity and the obligation to oppose Lanzce Douglass' testimony, Harley Douglass did not dispute or challenge in any way any of Lanzce Douglass' testimony regarding the costs already expended on the project, the additional costs required, the date of preliminary plat approval, the date of expiration, and the statistics for home sales at other new developments in the area.

As the record makes clear, both Harley Douglass and Lanzce Douglass are experienced developers of long duration who have completed multiple residential subdivisions independently and together. *Dec. of Lanzce G. Douglass*, ¶ 13 (CP 12); *Dec. of Harley Douglass*, ¶¶ 7-9 CP 30; *Dec. of Lanzce G. Douglass*, ¶¶ 2, 4-5, 12 (CP 90-92). Both parties' status as experienced, substantial real-estate developers in Spokane County market was documented in the record by the size and number of developments they had completed or referenced in their declarations. The

Camelot development alone, which is the subject of this litigation, is identified in the record as 211 single family homes, six common space open tracts, with \$175,000 already incurred in the planning stage and approximately another \$1 million needing to be spent in the short-term to complete required infrastructure before expiration of the preliminary plat. *Dec. of Lanzce G. Douglass*, ¶¶ 8-10 (CP 92).

Any developer is qualified to testify as to the costs they have expended, the intended schedule for the project, the expected market and the basis for that belief, the costs remaining to be incurred, and the risks involved in delay. If any of Lanzce Douglass' facts, figures, or concerns were wrong, Harley Douglass had the full opportunity (and the obligation) to dispute the facts, challenge the testimony, or to present contrary evidence. He took none of those steps.

Lanzce Douglass' unrefuted testimony was that over \$175,000 had been invested in engineering and design and that these funds and the 211 residential lots were at risk of loss if Harley Douglass' inaction caused the preliminary plat to expire. *Dec. of Lanzce G. Douglass*, ¶¶ 8-9 (CP 92, lines 1-7). Lanzce Douglass provided a solid foundation for this concern because Harley Douglass had allowed another subdivision, Hunter's Pointe, to expire through inaction. *Dec. of Lanzce G. Douglass*, ¶ 12 (CP 92, lines 16-22). Lanzce Douglass' statement is fully consistent with, and

supported by, RCW 58.17.140 that governs the expiration of preliminary plats and sets express time limitations. None of these facts were disputed by Harley Douglass.

Lanzce Douglass also testified that an additional \$1 million needed to be spent on infrastructure before expiration of the preliminary plat in 2013. *Dec. of Lanzce G. Douglass*, ¶¶ 8 and 10 (CP 92). According to Lanzce Douglass, the parties had been unable to make any progress on the subdivision because of impasse since 2007 and "complete deadlock" since early 2008. *Dec. of Lanzce G. Douglass*, ¶ 12 (CP 92). These are facts within Lanzce Douglass' personal knowledge and facts that would be readily known to any developer of residential subdivisions. None of these facts were refuted by Harley Douglass despite the opportunity and obligation to do so if he disagreed or had contrary evidence.

Lanzce testified that the communications between the parties had been acrimonious and counterproductive and deadlocked since 2008 with no prospects of improvement. *Dec. of Lanzce G. Douglass*, ¶ 13 (CP 92). Even simple decisions, like the inclusion of a commercial area along the Highway 2 frontage, once made and agreed, were unilaterally repudiated and not followed by Harley Douglass. *Dec. of Lanzce G. Douglass*, ¶ 7 (CP 91). These are facts within Lanzce Douglass' personal knowledge and well supported by the documents he produced in support of his testimony.

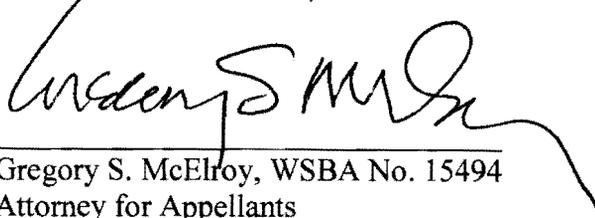
Lanzce testified by citing facts and statistics that other subdivisions in the immediate vicinity were successfully selling lots at favorable levels, citing the number of homes sold. Lanzce Douglass cited specific statistics regarding other plats in the general area that had closed or put under contract 10 homes within the prior eight months compared to 18 homes per year prior to the housing downturn. *Dec. of Lanzce G. Douglass*, ¶ 14 (CP 93). These are facts within the competence and common knowledge of experienced developers like Lanzce Douglass or Harley Douglass.

C. CONCLUSION

This Court should reverse the trial court's grant of summary judgment in favor of Secure Self Storage, LLC and remand the case for trial under the legal and equitable standard set forth in RCW § 25.15.275 and the operating agreement of the parties.

DATED this 20th day of June, 2012.

McELROY LAW FIRM, PLLC



Gregory S. McElroy, WSBA No. 15494
Attorney for Appellants

CERTIFICATE OF FILING & SERVICE

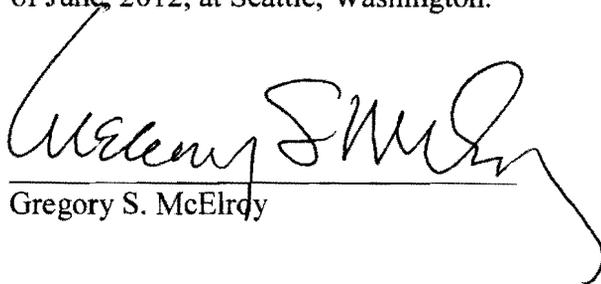
On this date, I caused a copy of the forgoing APPELLANTS' REPLY BRIEF to be served as follows:

Michael H. Church	<input type="checkbox"/>	Overnight Delivery via Courier
Stamper Rubens, P.S.	<input checked="" type="checkbox"/>	First Class Mail via USPS
720 West Boone Ave., Suite 200	<input type="checkbox"/>	Email mchurch@stamperlaw.com
Spokane, WA 99201-2560	<input type="checkbox"/>	Facsimile (509) 326-4891

with the original and one copy filed with Renee S. Townsley, Clerk/Administrator of the Court of Appeals, Division III, at 500 N Cedar Street, Spokane, WA 99201, via USPS First Class Mail, postage prepaid.

I make this declaration under penalty of perjury under the law of the State of Washington.

DATED this 20th day of June, 2012, at Seattle, Washington.



Gregory S. McElroy